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Interim report. 1967.

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ONTARIO

LEGISLATIVE ASSEMBLY

INTERIM REPORT – 1967

1967

INTERIM REPORT OF THE SELECT COMMITTEE ON COMPANY LAW

TABLED IN THE LEGISLATIVE ASSEMBLY BY
THE CHAIRMAN OF THE COMMITTEE,
ALLAN F. LAWRENCE, Q.C., M.P.P.

5th SESSION, 27th LEGISLATURE, 15-16 ELIZABETH II

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PROVINCE OF ONTARIO
LEGISLATIVE ASSEMBLY
SELECT COMMITTEE ON COMPANY LAW
INTERIM REPORT

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TERMS OF REFERENCE

On Tuesday, June 22, 1965 in the Legislative Assembly of Ontario, the Honourable Mr. John P. Robarts (The Prime Minister) moved, and the Honourable John Yaremko (The Provincial Secretary) seconded, a resolution, which read in part as follows:

> "That a select committee of this House be appointed to inquire into and review The Corporations Act of the province of Ontario and related Acts and regulations, including The Corporations Information Act and The Mortmain and Charitable Uses Act, and to consider the principles of the incorporation, operation, management and dissolution of corporations, including co-operatives, together with the legislation of other jurisdictions relating to the same matters.
>
> . . .
>
> And the said committee to consist of ten members to be composed as follows:
>
> Mr. Lawrence (St. George), chairman; Messrs. Carton, Eagleson, Henderson, Reilly, Renwick, Singer, Sopha, Thrasher and Welch."

The motion was carried.

In the Legislature on Friday, July 8, 1966, on a motion by Mr. Robarts (The Prime Minister), and seconded by Mr. Leslie Rowntree (The Minister of Labour), the Select Committee on Company Law was re-appointed with the same powers and duties as heretofore and Mr. Price (St. David) was added to the committee.

This motion was also carried.

TO: The Honourable Donald H. Morrow, Speaker of the Legislative Assembly of the Province of Ontario:

Sir:

We, the undersigned members of the Committee appointed by the Legislative Assembly of the Province of Ontario on June 22, 1965 to inquire into and review The Corporations Act and related Acts and regulations and to consider the principles of the incorporation, operation, management and dissolution of corporations, together with the legislation of other jurisdictions relating to the same matters, which Committee was added to and re-appointed on July 8, 1966, have now the honor to submit the attached Interim Report.

Allan F. Lawrence, Q.C. (St. George), Chairman

Gordon R. Carton, Q.C.

R. Alan Eagleson

Lorne C. Henderson

Leonard M. Reilly

H. J. Price

James Renwick, Q.C.

Vernon M. Singer, Q.C.

Elmer W. Sopha, Q.C.

Ivan W. Thrasher

The Hon. Robert S. Welch, Q.C.

PREFACE

The Committee was appointed during the last days of the 1965 Session of the Ontario Legislature. During the months of August and September of that year advertisements were inserted in all Ontario daily newspapers and many of the specialized journals and periodicals of the province to advise the public of the existence and purpose of the Committee. These notices requested the submission of oral or written briefs bearing on the matters within the terms of reference of the Committee.

Approximately 90,000 form letters were mailed to all corporations incorporated or carrying on business in Ontario, a copy of which forms Appendix E to this Report.

The Committee mailed a questionnaire to all interested segments of the public. After several amendments, this questionnaire formed the basis of the research studies of the Committee. The final amended form of the questionnaire appears as Appendix F to this Report.

As a result of the advertising and mailing and, in some cases as a result of direct enquiries and requests from the Committee, we received written briefs, communications or suggestions from many persons and organizations, some of which are referred to in Appendix G to this Report.

In the two-year period since the Committee was appointed, we have held 28 public meetings in Toronto, during which time we heard oral evidence and received written briefs.

During June and July of 1966, a working sub-committee of the Committee, composed of the Chairman, the then Director of Research and the then Secretary of the Committee, gained much useful information in London, England. We are most indebted to the Justices of the Companies Court and to the officers and staff of the Board of Trade, the London Stock Exchange and several eminent British solicitors for the hospitality and time they made available to us. In particular, we would like to record our indebtedness to:

Lord Justice Diplock and Justices Buckley, Pennycuick & Plowman	Royal Courts of Justice
Mr. L. C. B. Gower	Law Reform Commission

Mr. Patrick Jenkin, M.P.	
Mr. Registrar Berkeley	Companies Court
Mr. P. E. Thornton	Bureau of Economic Affairs of the Board of Trade
Messrs. J. A. E. Davies, J. B. Smith, G. F. Morris and B. J. Buckingham	Board of Trade
Mr. W. S. Wareham	London Stock Exchange
Members of the Quotations Committee	London Stock Exchange
Messrs. G. C. Butt and Parry-Wingfield	Confederation of British Industries
Mr. W. D. Scott	Association of British Chamber of Commerce
Mr. J. M. Renshall	Institute of Chartered Accountants of England and Wales.
Mr. R. C. G. Clarke and senior partners	Slaughter & May—Solicitors
Mr. W. J. Sandars and senior partners	Linklaters & Paines—Solicitors
Mr. C. P. L. Whishaw and senior partners	Freshfields—Solicitors
Mr. G. W. R. Morley and senior partners	Allen & Overy—Solicitors

On December 7, 1966, the entire Committee along with the Director of the Companies Branch, Department of the Provincial Secretary and four of his staff and members of the press, spent an extremely interesting and fruitful day in Albany, New York studying the corporation law practices and procedures of the Department of State of the State of New York. We would like to express our gratitude to Mr. J. Ghezzi—the Deputy Secretary of State and Messrs. Slutsky and Kantrowitz of the Department of State for their assistance.

On December 14, 1966, the Committee spent an interesting half-day viewing the electronic data processing equipment of the Ontario Department of Treasury and learned much of value to us.

In January 1967, the Committee and its counsel and the Director of the Companies Branch, Department of the Provincial Secretary, spent one week in California visiting both Los Angeles and San Francisco. We were privileged to have the benefit of the knowledge and experience of Professors Richard W. Jennings and Richard M. Buxbaum of the

University of California, Berkeley, and in addition had long and rewarding discussions with their distinguished colleagues in government, in Law Schools and in the practice of law in California. In particular we must indicate our gratitude to:

Mr. Jerry Schutzbank	Wyman, Finell & Rothman—Beverly Hills (previously California Corporations Commissioner)
Mr. R. E. La Noue	Assistant Commissioner of the Division of Corporations of the State of California
Mr. Marshall L. Small	Morrison, Foerster, Holloway, Clinton & Clark—San Francisco
Mr. Eric Sutcliffe	Attorney at Law—San Francisco
Mr. Paul L. Davies, Jr.	Pillsuby, Madison & Sutro—San Francisco
Mr. Chas. Rickershauser, Jr.	Munger, Tolles, Hills & Rickershauser—Los Angeles
Mr. Graham Sterling	O'Melveny & Myers—Los Angeles

Early in the Committee's deliberations we set up a University Advisory Committee composed of representatives of the Law Faculties of Universities in the Province of Ontario, and we are greatly indebted to its members for preparing major papers commissioned by the Committee.

Professor S. M. Beck—Faculty of Law Queen's University	An Analysis of *Foss v. Harbottle* and Corporate Amalgamations and Shareholders Rights.
Professor E. E. Palmer—Faculty of Law University of Western Ontario	Duties of Directors to Shareholders and Others.
Professor D. J. Sherbaniuk—University of Toronto Law School	Should the Doctrine of *Ultra Vires* be Abolished by Legislation.
Professor S. G. MacKinnon—Faculty of Law University of Ottawa	A Critical Analysis of the Rights of Dissenting Shareholders in United Kingdom, United States and Canadian Law.

Professor J. E. Smyth—School of Political Economy—University of Toronto	A Critical Appraisal of the Role of the Auditor.

In addition to field research by the Committee and its staff, and the above-mentioned public meetings, the Committee has spent almost five months, both while the Legislature was in Session and otherwise, considering successive drafts of the Interim Report submitted herewith.

During all the public hearings and meetings of the Committee, verbatim transcripts were made and these will be placed in the Legislative Library to be available to the general public and to any successor Committee.

The present Corporations Act of this province, which was the product of a previous Select Committee of this House, came into force on April 30, 1954. The records and Report of our predecessor committee proved most useful to us. Similarly, we had the benefit of the two Draft Uniform Companies Acts, prepared by a special committee of the Conference of Commissioners on Uniformity of Legislation in Canada. The Report published in March, 1965 by the Attorney General's Committee on Securities Legislation in Ontario (commonly known as the "Kimber Report"), to the extent that our areas of consideration over-lapped and the subsequent enabling legislation (enacted as The Securities Act, 1966 and The Corporations Amendment Act, 1966) were most valuable. In addition to these materials, we were fortunate to have available recent studies and legislation in other jurisdictions, such as the amendments to the Canada Corporations Act, enacted in 1965, and the new Companies Act of the Province of Manitoba, enacted in 1964. In the United Kingdom, The Report of the Company Law Committee presented to the President of the Board of Trade (commonly known as the "Jenkins Report") was of great benefit to us. A study of the Draft Uniform Companies Act enacted in the several states of Australia in 1961 received consideration, as did the Report of a Commission of Enquiry into the Company Law of Ghana and the subsequent Act enacted in that Republic in 1963.

Of all the materials of the various countries whose law and experience we reviewed, no materials received a closer examination and consideration than the federal and state laws of the United States. In particular, the Business Corporation Law of the State of New York and the Corporations Code of California were the subject of careful study by the Committee or its staff. The New York law was particularly prominent in our considerations because of the mammoth study undertaken by the Joint Legislative Committee to Study the Revision of Corporation Laws of the State of New York between 1958 and 1963, which culminated in the new Business Corporation Law of New York. Lastly,

in the United States, we found the model statutes such as the Model Business Corporation Act and the Uniform Commercial Code, prepared under the auspices of the American Bar Association, to be of practical value.

The Department of the Provincial Secretary of Ontario, and especially its Companies Branch, gave full co-operation to the Committee throughout its deliberations.

Mr. John G. Arthur, F.C.A. of Peat, Marwick, Mitchell & Co. was retained as a consultant to the Committee for the purpose of reviewing Chapter X of the Interim Report.

Although this Committee is indebted to a great number of persons and organizations, only some of whom are noted above, this Report would not have been possible had it not been for the ability, experience and determined purpose of our Counsel, Mr. Robert A. Davies, Q.C. of the Toronto law firm of Davies, Ward & Beck. Mr. Davies and our Assistant Counsel, Mr. Lionel H. Schipper of the law firm of Goodman & Goodman, were appointed at the first meeting of the Committee and have continued in these important offices to date. Both have worked unceasingly in the preparation of this Interim Report which has largely been the responsibility of Mr. Davies.

The Committee seconded Mr. Samuel Lavine from his important position in the Department of the Provincial Secretary to be the Director of Research to the Committee and we express our gratitude for Mr. Lavine's assistance. We regretted that for personal reasons Mr. Lavine had to resign from the Committee's staff.

Mr. Gerald D. Hyman, a Toronto solicitor, was appointed Assistant to the Director of Research on November 15, 1965, a position he fulfilled to the satisfaction of the Committee until he resigned on April 30, 1966 to take a position in private industry.

The Committee was served by two Secretaries: Mr. C. D. S. Robertson, a solicitor with the Attorney General's Department was part-time Secretary to the Committee until his resignation on May 15, 1966 to enter the private practice of law; Mr. F. J. Nugan, a former lecturer at Osgoode Hall Law School, ably served as Secretary of the Committee until his resignation on February 28, 1967.

The members of the Committee and the staff wish to express their appreciation to Mrs. Frances I. Nokes who so ably, over the whole of the period of the Committee's existence, has performed our innumerable secretarial duties and the management of the Committee's office.

At different times and in different areas of our research, the Committee was assisted by many lawyers, professors, chartered accountants,

investment dealers and members of the general public, to all of whom we express our deep appreciation.

In the Report, The Corporations Act is referred to as the "Ontario Act" or the "Act"; the 1962 United Kingdom Report of the Committee on Company Law is referred to as the "Jenkins Report"; and the Select Committee of the Ontario Legislature on Company Law which reported in 1952 is referred to as the "1952 Select Committee". The various references in the Report to "Anglo-Canadian jurisdictions" and similar phrases are not intended to include the province of Quebec.

INTRODUCTION

This is an Interim Report only, and we respectfully submit that the Committee should be reconstituted for the purposes referred to below.

Those terms of reference—reproduced in the Preface to this Report—are far wider in scope than those usually given to Select Committees of the Legislature.

Due to the length of the sittings of the Legislature and the consequent reduction of time available for Committee meetings, it was immediately obvious to the Chairman and members of the Committee that some limitations on the subject matters to be studied had to be set if even an Interim Report was to be produced before the eventual prorogation of this Legislature.

Very early in our discussions it was decided that, due to the Report of the Kimber Committee and the resulting enabling legislation arising therefrom (namely, The Securities Act, 1966 and The Corporations Amendment Act, 1966), the Committee would attempt to avoid a review of the aspects of corporation law dealt with in such Report and legislation.

The task undertaken by this Committee was to examine fully and consider the fundamental principles of corporation law in its general aspects. To our knowledge, never before in Canada has any legislative committee attempted a research and study of that nature.

This Interim Report does not discharge the duties imposed upon the Committee by the terms of reference. However, the Committee has reached conclusions on an important range of subjects within its terms of reference and we are of the opinion that these conclusions should be reported to the Legislature at this time. This Report is an Interim Report, not in the sense that its recommendations are tentative but in the sense that the Report does not embrace the entire range of topics within the Committee's terms of reference. Time available to the Committee necessitated that our study be confined to the problem areas associated with the ordinary commercial corporation in Ontario. No research or Committee consideration was given to the specialized types of corporations such as co-operatives, insurance companies, loan and trust companies, corporations without share capital, credit unions, finance and acceptance companies or extra-provincial companies.

Even within the self-imposed restrictions as to scope, the Committee has not been able to include in its Interim Report recommendations as to mergers or amalgamations, the rights of dissenting shareholders in the event of various fundamental corporate changes, the purpose, function and scope of the annual return, the field of corporation finance and the possible strengthening of the protection of the creditor.

These latter important subjects and the entire area of the specialized corporation require research and study and for that reason we recommend that this Select Committee be re-constituted. The re-constitution of the Committee, however, need not necessitate postponement of the implementation of the recommendations of this Interim Report. Within the limitations noted above, this Committee, as required by the resolution of the Legislature appointing it, addressed itself to many of the fundamental principles of corporation law. The recommendations made in our Report can be enacted into legislation without waiting upon further recommendations of a re-constituted committee. The Committee believes the recommendations in this Interim Report are of fundamental importance and that, in the public interest, their implementation should not be delayed pending study of the problems of the specialized types of corporations, as referred to above.

In the Committee's opinion, the Canadian economy, including the economy of Ontario, is well served by corporations and it should be or remain the public policy of this province to encourage the formation and use of companies. To that end, one of the keynotes which emerges from our Interim Report is the reduction and, if possible, the elimination of artificialities in corporation law.

This Interim Report is tabled in the hope that its contents will stimulate fresh thinking in the field of corporation law and commercial law generally and in the hope that a closer liaison will thereby result between government, practising lawyers, law school staffs and members of the financial community generally—a liaison which has been inadequate in the past.

The Committee made no detailed examination of the jurisdiction, authority and administration of the Companies Branch of the Department of the Provincial Secretary, and how these may be affected, if at all, by the new Department of Commercial and Financial Affairs.

In this spirit and with this type of wide-ranging Report, it is obvious that the opinions and recommendations which follow are not and cannot be the views of any one of us. There are opinions and recommendations contained in the Report with which the Chairman disagrees, and with which individual members of the Committee disagree. In short, we have compromised our disagreements in order to arrive at workable recom-

mendations of substance. However, the recommendations are, in every case, the majority opinion of the Committee in respect of each subject matter. No single member of the Committee should be held responsible for any one of the views contained in the Report.

We now submit our Interim Report and respectfully ask that the Committee be re-constituted for the purposes outlined above.

CHAPTER I

Formation of Companies

SECTION 1.

Incorporation—The Right to Incorporate.

1.1.1. For reasons that can now only be a matter of conjecture, one of the earliest general corporation statutes enacted in the Province of Canada in 1864 provided for incorporation by means of letters patent issued at the discretion of the Governor-in-Council. The United Kingdom had, two years earlier, enacted the Companies Act of 1862 providing for incorporation as a matter of right by means of a "registration" system. After Confederation, the Province of Ontario in 1874 re-enacted the 1864 statute providing for incorporation by means of letters patent to be issued at the discretion of the Lieutenant-Governor-in-Council. The incorporation of companies by virtue of the exercise of executive or ministerial powers of a discretionary nature having been thus established, the method has continued in this Province to the present time.

1.1.2. In the United Kingdom, grants of Royal charters constituting groups of merchant adventurers companies for the purpose of joint commercial enterprises can be found as early as the 15th century. Companies for the large part operated with these Royal charters, either obtained from the crown or purchased from languishing enterprises, until the burst of the South Sea Bubble in 1720. There were, of course, many unincorporated joint stock companies also operating in this period. Some of these Royal charter companies continued to exist after 1720 and a small number were incorporated after such date, but the real growth of companies, especially domestic commercial enterprises, came about through the growth of the unincorporated joint stock company, an entity contrived through a combination of partnership and trust law. This was the "deed of settlement" company devised by lawyers of the day so as to achieve the benefit of most of the characteristics of its chartered counterpart. There were earlier corporation statutes, but the most notable early Act was the Joint Stock Companies Act of 1844 initiated by Gladstone while he held the office of President of the Board of Trade. The 1844 Act provided for incorporation by registration, required registration of all new companies with more than 25 members or with shares transferable without the consent of all shareholders and provided for publicity of the companies' affairs. In 1855 limited liability was accorded incorporated companies which complied with certain prerequisites and ultimately the Act of 1862 eclipsed earlier legislation, providing, as did its predecessors, for incorporation by registration as a matter of right. At the present time in Canada there are five provinces whose corporation

statutes are direct descendants of the English Act of 1862 and which provide for incorporation as a matter of right by registration of a memorandum of association or some similar instrument. These jurisdictions are British Columbia, Alberta, Saskatchewan, Nova Scotia and Newfoundland. In the United States, in all jurisdictions except Georgia, incorporation is effected as a matter of right by filing with an administrative agency a document called articles of incorporation or a certificate of incorporation or upon the issuance of the certificate of incorporation. The Canada Corporations Act and the statutes in Manitoba, Ontario, Quebec, New Brunswick and Prince Edward Island are all descendants, directly or indirectly, of the 1864 Act of the Province of Canada. They are unique in that they alone of all the jurisdictions in the common law world provide in their general corporation statutes for incorporation by the exercise of ministerial or executive discretion.

1.1.3. The Ontario Act provides as follows:

> "3(1) The Lieutenant Governor may in his discretion, by letters patent, issue a charter to any number of persons, not fewer than three, of twenty-one or more years of age, who apply therefor, constituting them and any others who become shareholders or members of the corporation thereby created a corporation for any of the objects to which the authority of the Legislature extends, except those of railway and incline railway and street railway corporations and corporations within the meaning of *The Loan and Trust Corporations Act*.
>
> . . .
>
> 4. The Lieutenant Governor may in his discretion issue supplementary letters patent to any corporation that applies therefor amending or otherwise altering or modifying its letters patent or prior supplementary letters patent.
>
> 5. The Provincial Secretary may in his discretion and under the seal of his office have, use, exercise and enjoy any power, right or authority conferred by this Act on the Lieutenant Governor, but not those conferred on the Lieutenant Governor in Council."

1.1.4. The Ontario Act thus imposes upon the Provincial Secretary the obligation to exercise a discretion with respect to each application for incorporation or for the issuance of supplementary letters patent, but prescribes no guidelines for the exercise of such discretion.[1]

1.1.5. How, in fact, is this executive or ministerial discretion exercised? The Department of the Provincial Secretary in its Brief to the 1963 Royal Commission on Crime stated:

> "Before exercising his discretion whether or not to issue letters patent, the Provincial Secretary seeks to satisfy himself that no public or

private interest would be prejudicially affected by the incorporation, and more particularly whether incorporation under the specific circumstances would be in contravention of a statute or would otherwise be for an unlawful purpose."

1.1.6. Over 7,000 applications for incorporation and over 1,300 applications for supplementary letters patent are filed with the Provincial Secretary's Department each year and these numbers will likely increase. The Committee has concluded that the duty and responsibility imposed upon the Minister by the Ontario Act in the exercise of his discretionary power to grant or amend charters of companies cannot be discharged in a meaningful way; that the Ontario system of incorporation by ministerial act is an historical anachronism which ought not to be preserved; and that modern public policy no longer requires that a corporation can come into being only by ministerial Act.

1.1.7. The present Ontario method of incorporation and charter amendment results in administrative procedures which are unnecessarily cumbersome and invite unwanted administrative interference. The existing practice of engrossing letters patent and supplementary letters patent for ministerial signature results in further delay. As a practical illustration, the Committee is advised that to incorporate a company in Ontario under the letters patent system requires at least three weeks and that to incorporate a company by way of certificate of incorporation in New York State requires not more than 48 hours, in each case assuming no undue difficulty as to the proposed corporate name.

1.1.8. In seeking an alternative to the method of incorporation provided in the Ontario Act, the Committee examined the relevant provisions of the Companies Acts of British Columbia, Alberta, Saskatchewan, Nova Scotia and Newfoundland which provide a "registration" method of incorporation directly derived from the United Kingdom Companies Act of 1862 and its successors. The Committee, however, is reluctant to recommend legislative changes in Ontario company law which are modelled after the law pertaining to the English business corporation which evolved, as noted above, from the incorporated partnership and joint stock company embryo. The alternative to incorporation and charter amendment by the exercise of ministerial discretion does not appear to lie with the adoption of the century-old English method which itself is showing signs of age.

1.1.9. Accordingly, the Committee recommends that the Ontario Act be amended to adopt a method of incorporation and charter alteration similar to that contained in the New York Business Corporation Law which appears to be one of the most desirable of the United States laws dealing with this subject. Under such Law[2] corporate existence commences upon the effective filing of a certificate of incor-

poration with the appropriate governmental agency provided only that the certificate so filed meets the requirements substantive and formal, of the Business Corporation Law. Under comparable legislation enacted in Ontario, an administrative review of the certificate of incorporation should ensure that the requirements of the Ontario Act are complied with before the certificate of incorporation is accepted for filing. The administrative function should ensure that the certificate does not contain anything contrary to the Act or to any other provision of the law. Incorporation will thus become a matter of right subject to compliance with the relevant provisions of the Act and subject to the availability and suitability of the proposed corporate name.

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1. For some judicial guidelines see *Sharp v. Wakefield et al* [1891] A.C. 173 (H.L.) and Re *Cole's Sporting Goods Ltd.* and *C. Cole & Co. Ltd.* and *Cole's Book Stores Ltd.* [1965] 2 O.R. 243 at 250 (C.A.).
2. See Appendix A for some of the relevant provisions of the New York Business Corporation Law.

CHAPTER I

Formation of Companies

SECTION 2.

Incorporation—The "One-Man" Company.

1.2.1. The original historical concept of the business corporation in England was that of a relatively large number of individuals associated together to carry on business in corporate form as a separate and distinct entity, initially as joint stock companies and later as commercial corporations formed under the United Kingdom Companies Act of 1862 and its successors.[3] Early corporation statutes reflected this concept in that in England, prior to 1908, seven incorporators and members (shareholders) were required at all times; by the 1908 amendments "private companies" were permitted to have only two incorporators or members.

1.2.2. The Ontario Act provides,[4] in effect, that three natural persons over the age of 21 years shall be the minimum number of incorporators permitted to apply for incorporation. The Ontario Act further provides[5], in effect, that in certain circumstances if a company exercises its corporate powers when the number of its shareholders is fewer than three, every person who was a shareholder during such time, and who is aware of the fact that the company so exercised its corporate powers, is severally liable for the debts contracted by the company during the period in which the company had less than the statutory minimum number of shareholders.

1.2.3. This Committee, as was the case with the 1952 Select Committee and with the Jenkins Committee, has considered whether the law should permit the so-called "one-man" company, that is, a company having but a single shareholder. For practical purposes, the one-man company has been recognized in law since Salomon's case.[6] Particularly is this true in Ontario and other jurisdictions which provide for private companies. The private or closely-held company is not infrequently beneficially owned by one person or company. The law should be brought in line with reality by giving statutory sanction to the judicial recognition of one-man companies. The limited company, being a separate legal entity distinct from its incorporators and shareholders, it should not matter, in law, whether a company has one beneficial owner or many or whether such one owner is a natural person or a company.

1.2.4. The Jenkins Committee arrived at the opposite conclusion. Commenting on the suggestion that the requisite minimum number of shareholders of a company should be one for all companies, public or private, the Jenkins Committee stated[7]:

"We recognize the force of these arguments [in favour of giving statutory sanction to the one-man company] but in our view the practical advantages of making the change are insufficiently great to justify the consequential alterations of existing law and practice. Especially is this so in the light of our later recommendation that every company should have at least two directors and that the first two subscribers to the memorandum should be deemed to be directors unless and until the Registrar is notified of others. This recommendation is designed to discourage irresponsible incorporations; and a change which would enable one man, by merely signing a piece of paper and complying with certain statutory requirements, to convert himself into a company and to repeat this performance as often as he wishes, might be thought to encourage them."

1.2.5. We have not considered this line of reasoning convincing in the light of modern business conditions. Incorporators of companies today are rarely, if ever, the promoters. Almost invariably the several incorporators are mere nominees designated by the solicitor preparing the incorporation documents. Very frequently the private or closely-held company has but a single beneficial owner, all other shareholders being, again, mere nominees of such owner.[8] As was said by the Joint Legislative Committee to Study the Revision of Corporation Laws of the State of New York:

"The law to engender respect should itself respect realities. This is especially true, and does not import any sense of weakness, when no substantive policy of law argues to the contrary, as with incorporators."

1.2.6. The majority of corporations in Ontario are no doubt in essence "one-man" companies. The Committee has concluded that the existing statutory minimum number of three incorporators (and, inferentially, of shareholders) is arbitrary and artificial causing unnecessary inconvenience. We do not consider that a reduction in the number of incorporators of companies would encourage "irresponsible incorporations" or facilitate fraud. The concept of "one-man" companies can be given recognition in the Ontario Act without detrimentally affecting rights of creditors or other persons dealing with corporations. This recommendation would bring Ontario law into line with the laws of 16 of the states of the United States including New York, Pennsylvania, Illinois and Michigan. To avoid technical difficulties in the case of the death of the shareholder of a one-man company, Section 77 of the Act should be amended so as to state clearly that the personal representatives of a deceased shareholder should be deemed to be shareholders of the com-

pany for all purposes with the same voting rights as had the deceased shareholder.

1.2.7. The Committee recommends that the Ontario Act be amended to adopt, in principle, the concept embodied in Section 47 of the Model Business Corporation Act prepared by the Committee on Corporate Laws of the American Bar Association, which section reads in part as follows:

> "One or more persons, or a domestic or foreign corporation, may act as incorporator or incorporators of a corporation . . ."

This recommendation reflects the view of the Committee that modern corporation law should impose minimum restrictions on and afford maximum convenience and simplicity to incorporation and organization of companies. As a corollary to this recommendation, the Committee suggests that the Act be further amended so as not to require the incorporator or incorporators to be subscribers for shares.

---

3. Witness the fact that only new joint stock companies with 25 or more members or with shares transferable without the express consent of all the members were required to register under Gladstone's Joint Stock Companies Act, 1844 (7 and 8 Vict. c. 110).
4. Section 3(1).
5. Section 322.
6. *Salomon v. Salomon & Co. Limited* [1897] A.C. 22. (H.L.).
7. Jenkins Report, para. 21 et seq.
8. This state of affairs is encouraged by the effect of section 299 of the Ontario Act which does not require directors to own beneficially the shares held for qualification purposes. In the Committee's opinion, Section 299(1), (2) & (3) serve no useful purpose and should be repealed.

CHAPTER I

Formation of Companies

SECTION 3.

Minimum Number of Directors.

1.3.1. In Section 2 of Chapter I the Committee recommended the statutory recognition of the "one-man" company. Concomitant with that recommendation, the Committee has concluded that no useful purpose is served by Section 296(2) of the Ontario Act that requires the fixed number of directors to be no fewer than three. We feel that the requirement that every company have not less than three directors is arbitrary and artificial. The Committee therefore recommends that the statutory minimum of directors should, in most cases, be reduced to one. However, if the issued shares of the company are owned beneficially and of record by 15 or more shareholders, the Act should provide that the number of directors of the company shall be not less than three. This will ensure that publicly-held companies have a minimum of three directors.

1.3.2. There is no reason to assume that difficulties need arise on the death of a single director, for even in cases where a company has only a single shareholder and a single director, the legal personal representatives of the deceased shareholder can readily fill the vacancy in the office of director pursuant to Section 77 of the Act as proposed to be amended as recommended in paragraph 1.2.6.

CHAPTER I

Formation of Companies

SECTION 4.

Minimum Paid-Up Capital.

1.4.1. The Ontario Act contains no requirement that a company have, at the outset of doing business or at any other time, any minimum paid-up capital. While it is true that under-capitalization of companies is one of the major causes of business failures, the Committee has concluded that providing for a statutory minimum capital base would not lead to any abatement of that serious problem. Even if the complex variations of business and promotional factual situations would permit a formula to be devised prescribing statutory criteria of minimum capital at the outset of the corporate life, how could such formulae be adjusted to reflect the changing needs of the corporation as its corporate life goes on? Continuing minimum paid-up capital requirements could as readily work against as for the interests of creditors and others dealing with the company because management's judgment as to the amount and use of capital would thereby be impeded arbitrarily without regard to the particular financial exigencies.

1.4.2. All company law which has evolved from United Kingdom sources (however greatly changed in the evolution process) vests management of companies, including financial management, in the boards of directors. To depart from this principle so far as concerns minimum paid-up capital requirements would not be warranted because the Committee considers that clear and workable statutory rules could not be devised which could adequately cope with the complexities of commercial affairs, nor would such rules be readily enforceable.

1.4.3. The Committee is of the opinion that any legal requirement as to adequate capitalization of companies should come into being, if at all, through the development and extension of the duties and responsibilities of directors toward shareholders, creditors and others, a topic extensively dealt with in other Chapters of this Report.

CHAPTER I

Formation of Companies

SECTION 5.

Pre-Incorporation Contracts.

1.5.1. Very often before a company is formed, the persons or companies (in this Section for convenience referred to as the "promoters") who, in one capacity or another, are instrumental in causing the company to be formed, find it necessary or advisable to enter into agreements or commitments for or on behalf of the company to be formed. All the various categories of these agreements or commitments are usually described, rather loosely, as "pre-incorporation contracts". Under present law in Ontario and in the other Anglo-Canadian jurisdictions the company, when it comes into existence, cannot unilaterally adopt a pre-incorporation contract but must, if it seeks to benefit from the contract, enter into new contractual relationships with the parties concerned. Further, the third party involved in these transactions (in this Section for convenience referred to as the "contracting party") may not, in law, be able to enforce the pre-incorporation contract either against the company after its incorporation or against the promoters. In some cases, however, because of subtle differences in document wording the promoters may remain liable to the contracting party whether or not the company adopts the contract. In cases where the document wording does not render the promoter liable, the contracting party may have no defendant to sue.

1.5.2. In England, prior to 1856, no impediment existed to prevent a company coming into existence burdened with obligations contracted for it by its promoters—"in esse cum onere". During the period 1856 to 1866 this legal position was abandoned by judicial decisions culminating in the leading case of *Kelner v. Baxter*.[9] In that decision the court of Common Pleas concluded by applying a conglomeration of agency and contract rules of the day that the promoters of a company were themselves bound by contract by virtue of the fact that at the time of contracting the promoters had no principal (the company not yet being incorporated) who at that time became bound by contract or who could become so bound by subsequent ratification. The rule of law propounded in *Kelner v. Baxter* has survived in Anglo-Canadian jurisprudence to the present time.[10]

1.5.3. The Committee has concluded that the present state of the law relating to pre-incorporation contracts generally is unsatisfactory and replete with serious difficulties for promoters, companies and the public at large.

1.5.4. To deal first with a preliminary matter: Section 286 of the Ontario Act[11] appears on its face to be applicable to contracts made for its benefit prior to a company coming into existence. The Committee has concluded, however, that the Section does not, and historically was not intended to, apply to pre-incorporation contracts as such. The predecessor of Section 286 is to be found in one of the earliest general corporation statutes passed in the Province of Ontario.[12] There can be no doubt that the enactment was intended to serve as a basis for a transition from the joint stock company whose assets were held under a trust to the new letters patent company contemplated by such statute.[13] Presumably, the provision served that purpose for which it was intended. However, in the opinion of the Committee, Section 286 has long since ceased to have any effective reason for existence and the Committee therefore recommends that the Section be repealed.

1.5.5. The law in Ontario and, it would appear, in all the common law Provinces of Canada, is to the effect that no pre-incorporation contract is binding upon a company, no matter how or by whom the contract is made. For the company to be bound by such a contract or, alternatively, to obtain the benefit of it, a new contract must be made between the newly-incorporated company and the contracting party. Whether or not the contracting party has a remedy against the promoter (to whom he may or may not have intended to look for liability) depends, in the present state of the law, in large part upon caprice: the manner of execution of the particular contract. The multifarious judicial decisions seeking to apply the rule of *Kelner v. Baxter* have not consistently protected the separate interests of the parties to the pre-incorporation contract.[14]

1.5.6. The various States of the United States have, in large part, rejected the rule of law embodied in *Kelner v Baxter* by determining, through judicial decisions, that a corporation may, either expressly or even by the slightest implication, "adopt" or "ratify" a promoter's contract made on its behalf prior to incorporation.[15] The American courts have also held the promoters liable on pre-incorporation contracts in certain circumstances, even in cases where the corporation has adopted or ratified the contract and thus become liable under it. By this artificiality the plaintiff has acquired two defendants, one of which we can surmise he never intended to have.

1.5.7. To the Committee it appeared that two basic questions of policy were involved in this topic: Should companies be bound by pre-incorporation contracts made on their behalf, perforce, and without power to reject them? And, secondly, if a company is to be bound by a contract made before the company comes into existence, what class of persons should have that authority? Argued from the company's standpoint, it should not be possible for the traditional management functions of the directors and officers to be abrogated by permitting promoters to

bind companies in contract prior to incorporation. On the other hand, the contracting party, presumably a member of the public acting in good faith, should not be left without redress if the company is not bound by the contract, whether by election or otherwise. Again from the company's standpoint, the two questions posed above are really one: Is there any class of persons who should have the authority to bind a company in contract prior to its incorporation? In the opinion of the Committee, the answer to this latter question should be in the negative. The Committee recommends, however, that the so-called rule in *Kelner v. Baxter* should be repealed in that the Ontario Act should provide that a company may by its unilateral act, whether express or implied, be permitted to adopt and therefore take the benefit and assume the liabilities of a contract made in its name or on its behalf prior to incorporation. The promoters should cease to be liable under any contract so adopted by a company. Pursuant to these rules it would follow that promoters would bear the risk of non-adoption of pre-incorporation contracts—a risk which is properly inherent in the role of promoter. Companies, on their part, would be free to assume the benefits of pre-incorporation contracts made on their behalf. The Act should provide that in cases where the contract is not adopted by the company, the company should be required to restore to the promoters, in specie or otherwise, any benefit acquired by the company under the pre-incorporation contract not adopted after incorporation.

1.5.8. These recommendations, however, do not fully resolve the difficulties arising in pre-incorporation contract situations. Circumstances could exist, it seemed to the Committee, in which a company should not be permitted, by non-adoption, to avoid obligations under pre-incorporation contracts made on its behalf and, conversely, the promoters should not, in some circumstances, be freed from liability because the company adopts the contract. For example, if the promoters in fact become the sole or dominant shareholders and directors of the company on whose behalf a pre-incorporation contract was entered into, should the contracting party not have the right to enforce contractual liability against either the company or the promoters as the contracting party may elect? We therefore recommend that the Act be amended to include a provision to the effect that a contracting party may make an application to a judge of the High Court of Ontario designated by the Chief Justice of the High Court for an order that the promoters and the company will be jointly and severally liable under a pre-incorporation contract if, under the circumstances, it is just and equitable in the interests of the contracting party for such liability to be imposed.

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9. (1866) L.R. 2 C.P. 174.

10. The recent case of *Newborne v. Sensolid (Great Britain) Ltd.* [1954] 1 Q.B. 45; [1953] 1 All E.R. 708 (C.A.) represents the highwater mark in the diffi-

culties caused by pre-incorporation contracts in that the court in that case held that " . . . as the company was not in existence when the contract was signed there never was a contract". The adverse implications of this to suppliers and other persons contracting in good faith with companies not yet in existence are apparent. See also *Rumford v. Hinton* (1922) 52 O.L.R. 47, [1923] 2 D.L.R. 471 (C.A.) and *Murray Elias Ltd. v. Walsam Investments Ltd.* [1964] 2 O.R. 381.

11. Substantially similar provisions appear in the Companies Acts of Quebec, New Brunswick, Prince Edward Island and in the Canada Corporations Act.
12. The Ontario Joint Stock Companies Letters Patent Act, 1874 (S.O. 37 Vict., c. 35, s. 10).
13. See Gower, The Principles of Modern Company Law (2nd Ed. 1957) c. 2.
14. The cases are exhaustively catalogued in the standard texts. See, for example, Palmer's Company Law (20th Ed. 1959) p. 229 et seq.; Gower, *supra* p. 265 et seq.; Wegenast, Canadian Companies (1931) p. 261 et seq. and Fraser & Stewart, Company Law of Canada (5th Ed. 1962) p. 119 et seq.
15. In *Indianapolis Blueprint & Manufacturing Co. v. Kennedy et al* (1939) 215 Ind. 409, 19 N.E. 2d 554 Shake J. said:

    "Manifestly no formal resolution of a board of directors is required to effect a ratification; yet something more is demanded than a mere acceptance of benefits which the corporation has no power to reject without uncreating itself. We believe the rule applicable may be more clearly stated as follows: A corporation may, in the absence of a charter or statutory provisions to the contrary, make a promoters' contract its own in the same manner that it might itself enter into a contract of a similar nature as one of the original contracting parties . . This pre-supposes that there may be an implied ratification under some situations . . ."

    See also Ballantine, On Corporations (Rev. Ed. 1946) p. 103 et seq.; Lattin, The Law of Corporations (1959) p. 100 et seq.; and Lattin & Jennings, Cases And Materials on Corporations (3rd Ed. 1959) p. 236 et seq.; Baker & Carey, Cases and Materials on Corporations (3rd Ed. 1959) p. 71 et seq.

CHAPTER II

Classification of Companies

SECTION 1.

Distinction between Public and Private Companies

2.1.1. Under the Ontario Act a distinction is made between public and private companies. A public company is " . . . a company that is not a private company"[16] and a private company is defined[17] as " . . . a company as to which by its special Act, letters patent or supplementary letters patent,

(i) the right to transfer its shares is restricted,

(ii) the number of its shareholders, exclusive of persons who are in the employment of the company, is limited to fifty, two or more persons holding one or more shares jointly being counted as a single shareholder, and

(iii) any invitation to the public to subscribe for its shares or securities is prohibited;".

2.1.2. The statutory distinction between public and private companies was introduced into the English Companies Act in 1908[18] and was adopted in Ontario in 1912.[19] The distinction also appears in the Canada Corporations Act and the Companies Acts of all Provinces of Canada except Quebec and Nova Scotia. A similar distinction appears in the corporation statutes of Australia and its states, Ghana and South Africa, but is apparently unknown in the United States of America. In the United States, companies that are privately held are often referred to as "closely-held" companies.

2.1.3. The Ontario Act now contains a number of provisions which recognize and emphasize the distinction between the public and the private company, such as: a private company must have the words "private company" on its corporate seal and share certificates[20]; a private company cannot issue share warrants, that is negotiable instruments in bearer form whereby its shares may be transferred[21]; a private company (but not a public company) may make loans to its shareholders or directors to enable them to purchase issued shares of the company[22]; and a private company, as contrasted to a public company, need not forward its annual statements to its shareholders, unless demanded.[23] If a private company contravenes the terms of its charter respecting the restriction on the right to transfer its shares, the limitation on the number of its shareholders or the prohibition on invitations to the

public to subscribe for its shares or securities, the Act states that it ceases to be entitled to the privileges and exemptions conferred on private companies under the Act.[24] These various statutory provisions which arise out of the distinction between public and private companies are not derived from the historical basis for the existence of the distinction between the public and the private company.

2.1.4. Such historical basis for the distinction is best illustrated by the following extract from the Jenkins Report[25]:

> "56. Until the Companies Act, 1908, no companies were required to file accounts with the Registrar of Companies. That Act introduced the distinction between public and private companies and required the former but not the latter to file a statement in the form of a balance sheet. The Companies Act, 1948 introduced the further distinction between exempt and non-exempt private companies and required all companies other than exempt private companies to file accounts. The exempt private company, defined in section 129(4) and the notoriously complicated Seventh Schedule of the Act, is not only exempted from the requirement as to the filing of accounts: it need not appoint a qualified accountant as auditor and may appoint as auditor a partner or employee of an officer of the company (provisos to subsections (1) and (2) of section 161); and it is not subject to the otherwise general prohibition, in section 190, against a company's making loans to its directors. It enjoys these privileges in addition to those accorded to non-exempt private companies, to which further reference is made below.
>
> "57. The Cohen Committee admitted that their proposed definition, which was broadly that adopted in the Act, of the exempt private company was complicated and would involve some anomalies, but they recommended its adoption as the best that could be devised to save the small family business from disclosing its affairs to the public. Nevertheless we doubt whether the definition has worked out as the Committee or Parliament intended."

2.1.5. The Jenkins Committee re-examined the historical nexus between the concept of the private company and the desirability of distinguishing between those companies which should and those companies which should not make public their accounts. The Jenkins Committee concluded[26] that there should be no distinction in the Companies Act in the treatment of public and private companies, a decision substantially based on that Committee's further conclusion that all limited companies incorporated under the United Kingdom Act should be compelled, without exemption, to file annual accounts with the Registrar of Companies.

2.1.6. Ontario companies, whether public or private, have never been required to file, and make public, annual financial statements with the Provincial Secretary or with any other governmental agency. The requirement as to the filing of accounts instituted by the 1908 amendments to the United Kingdom Act were, on the other hand, adopted by the Provinces of British Columbia, Alberta and Saskatchewan and the predecessors to the Canada Corporations Act, which jurisdictions compel public companies to file annual balance sheets in offices of public record. Whether or not the concept of the private company should be retained in Ontario law is, accordingly, a question which the Committee determined it could consider apart from the more controversial issue as to whether or not companies should be required to make public detailed information as to their financial affairs.[27]

2.1.7. The second, but presumably less important, historical basis for the evolution of the private company in England and in those few jurisdictions which followed suit was the prohibition against such private companies offering their shares and other securities to the public. However, protection of the Ontario public in respect of the sale and distribution of securities is clearly the province of the securities laws of Ontario, recently overhauled and up-dated.[28] A charter prohibition against offering securities to the public is not an efficacious method of regulating against improper distribution of corporate securities.[29] The Committee has therefore concluded that the concept of the private company need not be retained in Ontario law as any necessary adjunct to provincial securities laws.

2.1.8. The Committee has concluded that the statutory concept of the "private" and "public" company has insufficient merit to warrant its continued existence in Ontario law. Of the original historical bases for the distinction in company law between the private and public company, one was never incorporated into the Ontario Act and the other has become meaningless in the light of modern securities legislation. None of the provisions in the Ontario Act referred to in paragraph 2.1.3. which specifically deal with private companies have sufficient intrinsic merit to warrant the continued statutory recognition of the private company status, and the Act should therefore be amended and varied appropriately.

2.1.9. This recommendation of the Committee does not extend to the abolition of the principle of Section 39 of the Act which permits the charter of any company to restrict the transfer of its shares; no doubt the charters of many closely-held or family companies will continue to contain prohibitions against free transferability of shares.

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16. Section 1(g).
17. Section 1(f).

18. Companies (Consolidation) Act, 1908 (8 Edward VII. c. 69).
19. The Ontario Companies Act, 1912 (S.O. 2 Geo. V. c. 31).
20. Section 21 (3) and 45(1) (d) respectively.
21. Section 48.
22. Section 23(2) (e).
23. Section 93. As to other provisions dealing with private companies, see Sections 3(2), 27(9), 33(1) (l), 33(1)(o), 81(2), 98 and 99.
24. Section 98.
25. Jenkins Report, para 56.
26. Jenkins Report, para 67.
27. See Chapter XIII.
28. The Securities Act, 1966, S.O. 1966 c.142.
29. See *Regina v. Golden Shamrock Mines Ltd. et al*, *Regina v. Langs* [1965] 1 O.R. 692 (C.A.).

CHAPTER II

Classification of Companies

SECTION 2.

The Professional Service Corporation.

2.2.1. Historically, professional persons of all common law jurisdictions have been denied the right to incorporate their professional practices and to obtain thereby the benefits which are available to those who carry on other businesses in incorporated form. Exceptions or deviations from this prohibition, however, are increasing.

2.2.2. In Ontario, for example, professional engineers, pharmacists, and dental technicians may utilize the corporate form provided that such persons comply in so doing with applicable law or regulations imposed either by statute or by the rules of the associations to which such professional persons belong.[30] In the United States, statutes have been passed in almost half the States conferring the right to incorporate either upon professional persons generally or, in some cases, on specific professionals such as doctors or lawyers.

2.2.3. The Ontario Act provides that[31]:

> "The Lieutenant Governor may in his discretion, by letters patent, issue a charter . . . constituting [the applicants for incorporation] and any others who become shareholders . . . of the corporation thereby created a corporation for any of the objects to which the authority of the Legislature extends, except those of railway and incline railway and street railway corporations and corporations within the meaning of *The Loan and Trust Corporations Act*".

It is clear, therefore, that there is no prohibition in the Ontario Act against persons applying for the incorporation of companies to carry on the practice of law, medicine, accounting, engineering and any other "profession". In actual fact, however, most of the governing bodies of these and other professions have, pursuant in some cases to statutorily conferred powers, passed rules or regulations prohibiting persons subject to their jurisdiction from carrying on business in incorporated form. The Committee understands, further, that at least some of such associations have advised the Provincial Secretary of these prohibitions with the result that the Provincial Secretary is not prepared, in most cases, to entertain an application for incorporation of a company with objects which include carrying on the practice of certain professions.

2.2.4. There are a number of persuasive arguments in favour of permitting incorporated professional practices: carrying on a professional

practice in corporate form permits clarification of the legal relationships between shareholders of the company and third parties; simplifies or eliminates difficulties arising by virtue of the withdrawal, retirement or death of members of a professional partnership; expedites transfer of interests in the practice from one person to another or to incoming members of the practice; and permits the accumulation of partnership profits for the purpose of re-investing in fixed assets or for other purposes. In addition, there are, under existing law, very real income tax advantages which would accrue to the professional person or partnership on incorporation of the practice. There seems to be no reason why all these advantages should not be available to those who are active in professional life.

2.2.5. Not a few of the objections to permitting an incorporated professional practice seemed to relate to specific relatively minor problems which are said to arise from permitting the incorporated practice, for example, should the directors and shareholders all be required to be licenced practitioners of the particular profession? The main objection of substance to permitting incorporated professional practices seems to be the apprehension of professional associations and licensing bodies that once the professional man is cloaked with the corporate form, the professional relationship between the professional and his patient or client will be impaired, if not severed, thus resulting in detriment to the public generally.

2.2.6. On balance, the Committee has concluded that the objections to incorporating the professional practice are unfounded and the Committee therefore recommends that the Ontario Act be amended by adding as a new Part a code of rules designed to permit the incorporation of professional service companies. It seems unrealistic to prohibit medical, legal, accounting and architectural practices, for example, from being carried on in incorporated form when at the present time such practices are in fact carried on, in some cases, in very large partnerships.

2.2.7. The recommended code of rules for professional service companies should contain provisions designed to make allowance for the concern that the professional relationship might be adversely affected. For example, the professional person, albeit practising his profession through the instrumentality of a corporation, should remain personally liable for his tortious Acts jointly and severally with the company.[32] Further, the code should provide that the particular professional service may only be rendered to members of the public through natural persons who are duly licenced to render such professional service.[33] Whether or not the persons rendering the professional service must be shareholders and directors of the corporation or whether they can be employees only

is a question the answer to which may vary from one profession to another. The suggested code will undoubtedly require that the term "profession" be defined. This can be done either by reference to specific occupations or, perhaps, defined in general terms.[34] Care should be taken to ensure that the legislation does not impinge upon the existing ethics and rules as to privileged professional communications. The Committee suggests that the new Part in the Act should stipulate that the professional service corporation should be incorporated with objects limited to carrying on the particular practice and other objects necessarily incidental or ancillary thereto. It is also recommended that the name of the professional service corporation should include some words or initials to ensure that the public is aware of the fact that the corporation is, in effect, an incorporated professional practice of some kind. The Committee has concluded that there is no reason why the professional service corporation and its shareholders may not enjoy limited liability for debts or other obligations except liabilities arising for tortious acts as mentioned above. Further, the suggested code should make applicable, by appropriate reference, such other provisions of the Act and any legislation implementing this Report as are not in conflict with the specific provisions of the recommended professional business corporation code. Appropriate amendments will be required to be made to those provincial statutes which prohibit certain professional persons from incorporating their businesses or practices.

2.2.8. The Committee is of the opinion that incorporation of the professional practice should not detract from the professional nature, attitudes and ethics of the professions; nor should incorporation mean that the professional practice would erode the valuable and traditional relationship presently existing between the professional man and his clients or patients.[35]

2.2.9. The above recommendations, however, are not intended to imply that there should be any lessening of authority over professionals by the various associations or licencing bodies which under provincial statutory authority presently govern and regulate the professions. If the right to practice a particular profession requires licencing by a governing body, such requirement should continue, but those persons who are duly licenced by the appropriate authority should then be free to carry on their practice in an incorporated form. The suggested code for the professional service corporation should state that a governing or licencing body may not refuse to grant a licence to an applicant otherwise qualified merely because the professional practice is proposed to be carried on in an incorporated form. By the recommendations made in this Section, the Committee is suggesting that it should not be contrary to public policy in Ontario for professional persons to incorporate their practices. The Committee, however, with the exception noted above,

does not intend these recommendations to derogate from the authority presently vested in those associations which licence, discipline and regulate the various professions.

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30. The Professional Engineers Act, R.S.O. 1960, c. 309, The Pharmacy Act, R.S.O. 1960, c. 295, The Dental Technicians Act, R.S.O. 1960, c. 90.
31. Section 3(1).
32. The Kentucky Laws of 1962, c. 236, section 6 provides in part:
    "This Act shall not alter any law applicable to, or otherwise affect the fiducial, confidential, or ethical relationship between a person rendering professional services and a person receiving such services. The corporation shall be jointly and severally liable, with the tort feasor, to the full value of its assets for any negligent or wrongful acts or actionable misconduct committed by any of its officers, shareholders, agents or employees while they are engaged on behalf of the corporation in the rendering of professional service."
33. Minnesota Statutes of 1961, c. 319, section 319.15 reads in part:
    "A professional corporation may render professional service only through natural persons who possess a licence to render professional service of the type which the professional corporation was organized to render . . ."
34. Laws of Pennsylvania, 1961 Act 416, section 2(2):
    "'Profession' shall include all occupations, legally or traditionally designated as professions, and which members thereof by law, tradition, or ethics, are forbidden to incorporate for the purpose of rendering professional services, including, but not limited to, architects, attorneys at law, certified public accountants, chiropractors, dentists, ostepaths, physicians and surgeons."
35. cf. *Carruthers Clinic Limited v. Herdman*, [1956] O.R. 770.

CHAPTER III

Central Registry For Corporate And Business Names

3.1.1. To an increasing degree of frequency, corporations in Ontario and elsewhere carry on business or one or more divisions of their business in names other than the corporate names specified in their charters of incorporation. In the great majority of cases, this corporate use of assumed names is bona fide and founded on a proper business purpose. In a minority of cases, however, the assumed name is used by a corporation (formed with an innocuous name) which has been refused the assumed name by the Provincial Secretary in the exercise of his discretion under the Ontario Act; the intent of the law to avoid the use by companies of similar or identical names is thereby frustrated.[36]

3.1.2. In all cases of use by corporations of assumed names, whether bona fide or otherwise, the possibility of confusion in the minds of the public exists. Particularly is this so in that the corporation is not required to register in any office of public record notice of the fact that the business or division of the business is being conducted under a name other than that by which the enterprise is officially called. There is no doubt in Ontario law that a company is not prohibited from carrying on business in a name other than its corporate name; nor is the company required by law to register its assumed name.[37] Thus, the public frequently deals with a business unaware that it is in fact dealing with an incorporated company having limited liability. Non-registration of assumed names becomes particularly important if a member of the public wishes to take legal action or process against a business not being carried under its correct corporate name.

3.1.3. The Committee has concluded that the use by corporations of assumed names for trading purposes is an established commercial practice which should be allowed to continue.[38] The Committee recommends, however, that the Ontario Act be amended by adding, as a new Part, provisions to establish a central registry in the Province for the registration of business names.[39] It is suggested that the new Part adopt the principles of The Business Names Registration Act, 1965 of Manitoba in that provision should be made therein for the following:

1. "Business" should be defined to include every trade, occupation, venture or profession whether or not conducted or carried on with a view to profit other than a professional practice conducted either by an individual or a number of individuals in partnership if the particular profession is regulated by a self-governing body deriving its authority from a provincial statute.

2. A register should be maintained by the Provincial Secretary in which shall be recorded the names of every business required to be registered under the Part.

3. Every person, including a corporation, which carries on business either as a proprietorship or as a partnership or in corporate form under a name other than the name of such person must register the assumed name by a declaration filed with the Provincial Secretary within 30 days after commencing to carry on business. The declaration of registration shall include, in addition to the assumed name, the actual names and the business addresses of the owner or owners of the business and a brief description of the business. The applicant for registration shall be the person or persons or company or companies who propose to use the name. Notice of changes in these essential facts should be required to be filed with the Provincial Secretary.

4. Each registration of a business name shall expire after five years unless renewed from time to time.[40] Notice of impending expiration of registrations shall be forwarded to registrants by the Provincial Secretary.

5. The Provincial Secretary should be authorized to refuse registration of a business name if the name is objectionable on grounds similar to those set out in Section 12 of the Act in respect of company names. The Provincial Secretary should have power to direct the change of a name of a business with right of appeal to the court as is provided in Section 12(2) and (3) of the Act in respect of company names.

6. The Provincial Secretary should be empowered by application to the court to compel compliance with the Act.

7. Registration of business names should be required of all businesses carried on in Ontario whether or not the person or company carrying on the business is a resident of or incorporated under the laws of Ontario.

8. Registered business names should be disclosed in annual returns filed by companies.

3.1.4. The above recommendations stem from the Committee's view that the public should be protected from confusion of business names, whether the names are those of incorporated or unincorporated businesses. The recommendations presuppose that the registration of business and company names will be effected by electronic data processing equipment so that "name searches" by applicants for their proposed use or by creditors and others can be carried out with substantially greater dispatch than has been possible in the past. The Committee appreciates the difficulties which could attend this recommendation to require regis-

tration of all business names if an overly narrow or inflexible administrative attitude was adopted toward the availability of names. As the number of business and corporate names in use increases, the difficulties confronting both the commercial public and the Provincial Secretary and his staff will multiply. The Committee therefore suggests that the Provincial Secretary should develop departmental guidelines as to the availability of both business and corporate names, which guidelines should take into consideration location of business, nature of business and other essential factors in determining whether or not there are reasonable grounds for a possible risk of confusion in respect of a particular name.

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36. Section 12. The courts have held that the test of the proper exercise of discretion under Section 12 is not whether there is any intention to mislead or deceive but only whether there is a reasonable possibility of confusion: *Re F. P. Chapple & Co. Ltd.* [1960] O.R. 531; *Re C. Cole & Co. Ltd., Coles Books Stores Ltd.* and *Cole's Sporting Goods Ltd.*, [1965] 2 O.R. 243 (C.A.). Further, in the exercise of discretion under the Section regard must be had to the same or similar names of other corporations wherever incorporated and of associations, partnerships, individuals or businesses.
37. *Heriteau et al v. W. D. Morris Realty Ltd., trading as Capital Storage Company,* [1943] O.R. 724; *Tilden-Rent-A-Car v. Keffer* [1964] 2 O.R. 80. The Partnerships Registration Act which applies to partnerships and individuals engaged in trading, manufacturing or mining purposes under a name other than their own or under a plural name apparently does not apply to corporations. Registration under this Act is with the registrar of deeds in the land Registry Division in which the business is to be carried on and the usefulness of such registration to the general public is accordingly limited. Further, the local registrar has no authority under the Act to refuse registration on the grounds of similarity of names or for any other reason.
38. The Legislature of Quebec arrived at the opposite conclusion. The Quebec Companies Act provides that a company cannot, in the carrying out of its affairs, use any name other than that given to it by its letters patent. It is doubtful if the legislation achieves its objective.
39. The United Kingdom has provided for the central registry of business names since 1916 under the Registration of Business Names Act, 1916: see Jenkins Report paras. 436 et seq.
40. Hopefully, this will prevent the accumulation of numerous abandoned business names: see Jenkins Report, paras. 438-9.

CHAPTER IV

Capacity and Powers of Companies

SECTION 1.

The Doctrine of Ultra Vires.

4.1.1. The common law doctrine of *ultra vires* originated in the United Kingdom as a protection for creditors of and investors in limited companies. The doctrine renders void, without the possibility of ratification, any act which is beyond a company's capacity. In regard to a company incorporated under the registration system provided for in the United Kingdom Companies Act, an act considered beyond a company's capacity is one which is not expressly or impliedly authorized by statute or by the company's objects clauses as contained in its registered memorandum of association. As stated by the Cohen Committee which reported to the President of the Board of Trade in 1945[41]:

> "The memorandum of a company defines its objects and a company's objects are limited to those expressly mentioned and such as are ancillary to the expressed objects. A contract made by the directors upon a matter not within the ambit of the company's objects is *ultra vires* the company, and, therefore, beyond the powers of the directors. This principle is intended to protect both those who deal with the company, and its shareholders."

The Cohen Committee concluded, however, that:

> ". . . the doctrine of *ultra vires* is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company."

and, further, that:

> ". . . as now applied to companies, the *ultra vires* doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation."

4.1.2. The *ultra vires* doctrine was first fully expressed as a judicial principle in the leading case *Ashbury Railway Carriage & Iron Co. v. Riche*[42] in which it was held that any act by a company not expressly or impliedly authorized by its memorandum of association was *ultra vires* and therefor could not be ratified. The purpose of the doctrine was to protect creditors by ensuring that the company's funds to which creditors must look for payment were not dissipated in unauthorized activities and to protect investors by allowing them to know the objects for which their money was to be used. There is no doubt that the doctrine did, even at the outset, have the desired effect so far as creditors and investors were

concerned, but it also produced great hardship for persons doing business with companies in that such persons could not enforce obligations incurred by companies in *ultra vires* transactions. Ultimately, the protection provided by the *ultra vires* rule has been made ineffective by including in memoranda of association broad and comprehensive objects clauses. In addition, the United Kingdom Companies Act has, since 1875, been altered extensively to permit the amendment of the company's memorandum by changing its objects clauses. Thus, the element of protection which the doctrine afforded to investors and creditors has been dissipated while the danger of the *ultra vires* doctrine to third parties continues unabated. A detailed analysis of the effect and development of the *ultra vires* doctrine in the United Kingdom is probably not necessary for the purposes of this Report. It is sufficient to state that as a result of developments in statutory and case law in the United Kingdom since 1875 the whole object of the *ultra vires* doctrine has been largely frustrated, so that it has ceased to be an effective protection to anyone and has become merely a trap for the unwary third party and a nuisance to the company itself.[43]

4.1.3. The doctrine was incorporated into the laws of various States of the United States. However, because of the development in the United States of the doctrine of unjust enrichment, and because the great weight of American authority does not charge third parties with constructive notice of the contents of a company's by-laws, the adverse effect of the doctrine on third parties dealing with companies was greatly mitigated. In any event, many of the States have, by one means or another, abolished the doctrine by statutory amendment.

4.1.4. Prior to 1916 it was generally believed that the doctrine of *ultra vires* was applicable in Ontario. However, in that year the Privy Council decided in *Bonanza Creek Gold Mining Company Limited v. The King*[44] that the doctrine of *ultra vires* does not apply to a company incorporated by charter under the Ontario Act. The Privy Council held that an Ontario company, which is created by charter, has the capacity of a natural person to acquire powers and rights:

> "Such a company has the capacity of a natural person to acquire powers and rights. If by the terms of the charter it is prohibited from doing so, a violation of this prohibition is an act not beyond its capacity, and is therefore not *ultra vires*, although such a violation may well give ground for proceedings by way of *scire facias* for the forfeiture of the charter."[45]

4.1.5. As a result of the decision in the *Bonanza Creek* case, the Ontario Legislature in 1916 passed an amendment to the Ontario Act,

which is the predecessor to Section 287 of the present Act[46] intended, presumably, to give effect to the principles in that case. Prior to the *Bonanza Creek* decision it had been believed that an Ontario company could do only those acts authorized by its charter, that is, that the doctrine of *ultra vires* was applicable. The *Bonanza Creek* case is generally interpreted as having held that an Ontario company was not restricted by the doctrine so that a violation of a prohibition in its charter does not constitute an act beyond its capacity and therefore is not *ultra vires*. The amendment to the statute in 1916 provided that an Ontario company "unless otherwise expressly provided in the Act or instrument creating it" has and shall be deemed to have had from its creation the capacity of a natural person. Thus, the 1916 amendment confined the doctrine of *ultra vires* to an express restriction "in the Act or instrument" creating the company.

4.1.6. However, the effect and purpose of the 1916 amendment to the Ontario Act, which is the predecessor to Section 287 of the present Act, is put in confusion by the treatment which this subject has received in Ontario jurisprudence since 1916. A review of the jurisprudence is not, in our opinion, helpful to the determination of the question of principle faced by the Committee. If it is concluded that the limitation of a company's capacity by rendering *ultra vires* those acts prohibited by its charter is neither desirable nor warranted as protection for shareholders or investors or, perhaps alternatively, is not effective to achieve such protection, should not the doctrine of *ultra vires* be abolished? The Committee has concluded that there is no reason why acts of a company should be held to be *ultra vires,* as regards third parties, if done in contravention of some limitation or prohibition in the company's charter. An extension and clarification of the duties and responsibilities of directors towards the company and its shareholders is, in the Committee's opinion, a more desirable route by which to achieve protection of creditors and investors than is the unclear *ultra vires* doctrine which in its application has given rise to serious problems for third parties dealing with companies.

4.1.7. The Committee therefore recommends that the controversial Section 287 be repealed and that a provision substantially as follows be substituted therefor[47]:

> "Every corporation (a) has and shall be conclusively deemed to have had from its incorporation the capacity of a natural person, and that capacity, as regards third parties, is not limited by the terms of its charter; and (b) may exercise its powers beyond the boundaries of Ontario to the extent permitted by the laws in force where the powers are sought to be exercised, and may accept extra-provincial powers and rights."

By these recommendations the *ultra vires* doctrine, with all its attendant difficulties to the commercial public, would thereby be removed from Ontario law. If the Committee's further recommendation in Section 1 of Chapter VIII is adopted, the individual shareholder will be accorded the right to require compliance by the company with the provisions of its charter and by-laws.

41. Report of the Committee on Company Law Amendment, 1945, Cmd. 6659, paras. 11 & 12.
42. (1875) L.R. 7 H.L. 653.
43. Gower, supra at p. 85.
44. [1916] 1 A.C. 566.
45. [1916] 1 A.C. 566 at 584.
46. Section 210 enacted by S.O. 1916, 6 Geo. V, c. 35, s.6.
47. cf. Section 203 of the New York Business Corporation Law.

CHAPTER IV

Capacity and Powers of Companies

SECTION 2.

The Doctrine of Constructive Notice.

4.2.1. Under the United Kingdom Companies Act the memorandum and articles of association of a company are registered in a public office and are open for public inspection. The memorandum and articles of association are therefore public documents and, accordingly, by English law, anyone, whether a shareholder or an outsider, who has dealings with the company must be taken to have notice of the contents of the memorandum and articles. According to this doctrine of constructive notice persons dealing with the company are presumed not only to have read the documents in question but to have understood them according to their proper meaning.[48]

4.2.2. The doctrine or rule of constructive notice therefore entails important consequences so far as United Kingdom companies are concerned, inasmuch as the articles of association prescribe the internal rules and regulations of the company, specifying the powers of the directors and officers and similar significant matters of internal organization and structure. The doctrine operates in favour of and not against the company so that a person dealing with the company cannot claim the benefit of the rule as to constructive notice if he has not, in fact, examined the memorandum and articles and if, when contracting with a company, he was unaware of the provision on which he wishes to rely.

4.2.3. Conversely, under Ontario law, since the by-laws of a company (which correspond to the articles of association) are not documents of public record, a third party dealing in good faith with a company without notice or knowledge of any defect or irregularity is entitled to assume that all necessary acts have been done or taken by the directors and shareholders of the company provided only that the transaction is within the powers of the company. Under the Ontario Act only the letters patent and supplementary letters patent are documents of public record and a company is not, therefore, entitled to escape from the obligation of a contract entered into between it and a third party acting in good faith by setting up any breach of the company's by-laws or other regulations governing its internal affairs.[49] It follows, therefore, that the rule or doctrine of constructive notice, so far as Ontario companies are concerned, is applicable only to the provisions of the letters patent and supplementary letters patent. In order to make effective the recommendation in Section 1 of this Chapter that the *ultra vires* doctrine be removed from Ontario law, the Committee recommends that by appropriate amendment to the Act the rule or doctrine of constructive notice

be abolished as it might otherwise relate to the certificate of incorporation and amendments thereto contemplated by the recommendations in Chapter I of this Report.

48. Palmer, supra at 242 et seq.; Gower, supra at 141 et seq. However, so far as everything appears regular as can be checked from the public documents, a third party dealing with the company is entitled to assume that all internal rules and regulations of the company have been complied with, unless he has knowledge to the contrary or there are suspicious circumstances which put him on enquiry: *Royal British Bank v. Turquand,* (1856) 6 E. & B. 327; *Mahony v. East Holyford Mining Co.* (1875) L.R. 7 H.L. 869.
49. Re *W. N. McEachren & Sons Ltd.* [1933] O.R. 349 (C.A.); *Walton v. Bank of Nova Scotia,* [1964] 1 O.R. 673 at 687 et seq.

CHAPTER V

Share Capital

SECTION 1.

Non-voting Common Shares.

5.1.1. Should a company be permitted to issue common shares which carry no voting rights? Under the Ontario Act the letters patent or supplementary letters patent of a company may provide for voteless preference shares, but each common share is required to carry one or more votes.[50]

5.1.2. The law in Ontario regarding the right to vote at meetings of shareholders has undergone a major change since the enactment of the Joint Stock Companies Letters Patent Act, 1874.[51] That statute provided that "In default only of other express provisions in such behalf by the letters patent or by-laws of the Company . . . at all general meetings of the Company, every shareholder shall be entitled to as many votes as he owns shares in the Company . . .". Pursuant to this statutory provision, a company could therefore provide for non-voting common shares. This principle remained unchanged until 1953 when the present Sections 27(2) and 29 were enacted permitting restrictions or prohibitions on the voting rights attached to preference shares. Thus, from 1874 to 1953, the charter or by-laws of a company could restrict or eliminate the right to vote in regard to any class of shares, preference or common. After 1953, voting rights could be restricted or eliminated in regard to preference shares only. The Committee is advised that during the period from 1874 to 1953 only a relatively few charters were issued providing for voteless common shares.

5.1.3. None of the briefs or submissions made to the Committee advocated the adoption of the voteless common share. The topic was, nevertheless, studied by the Committee because the non-voting common share is permitted under the Companies Acts of all other Provinces of Canada except Prince Edward Island[52] and because the question of the retention of the voteless equity share was a very contentious issue before the Jenkins Committee.[53] In certain of the Provinces the use of the voteless common share is said to be widespread. The Registrar of Companies of Alberta, for example, advised the Committee that:

> "The non-voting shares provision is used rather extensively both by Private and Public companies, and insofar as I have been able to determine no evidence of abuse or inequities have been reported to this office, although no doubt such a restriction could be abused by unscrupulous persons."

Again, the Director of the Companies Branch of the Department of the Provincial Secretary of Manitoba stated:

> " . . . I find that the creation of nonvoting common shares is becoming increasingly popular [under the new Companies Act which came into force in November 1964] but to date it is being used solely for estate planning purposes in private companies. To my knowledge no Manitoba company has made a public offering of nonvoting common shares."

No abuses or improprieties were reported in any of such Provinces arising from the use of common shares carrying no right to vote.

5.1.4. In the United States, the use of voteless common shares largely died out subsequent to the mid-1920's as a result of the combined disapproval of the device by, first, the New York Stock Exchange and, later, the Securities and Exchange Commission.

5.1.5. In the United Kingdom the issue has been a contentious one. As the Jenkins Committee stated:[54]

> "No exception is taken to the restriction of voting rights so far as preference shares are concerned, but the practice of issuing ordinary or 'equity' shares without any right of voting, though not without its supporters, has been strongly criticized, and it is no exaggeration to say that there was a more marked division of opinion amongst our witnesses on this matter than on any other."

The non-voting common share is in widespread use in the United Kingdom even in the case of publicly-owned companies listed on stock exchanges. The opponents of the voteless equity share hold that, as a matter of principle, it is wrong that holders of shares representing a minor proportion of the equity or, perhaps, preference shares carrying no interest in equity should have voting control to the exclusion of shareholders representing a majority proportion of equity. A closer study of the United Kingdom controversy is, however, probably not germane to a consideration of the same question as pertaining to Ontario law and practice as the English problems concerning the voteless common share seem to be local issues.

5.1.6. Cogent and well-reasoned arguments can be made against the use of the voteless equity share.[55] Certainly their use is a derogation from the principle well founded in the company law of Ontario and most other jurisdictions that ultimate control over management, i.e. the directors, should be exercised by equity shareholders in general meeting. As noted above, none of the briefs or submissions made to this Committee urged the adoption of the non-voting common share. In the Com-

mittee's opinion, no case has been made out either for corporation or tax law purposes, which would warrant the adoption of voteless common shares in the law of Ontario. The dangers inherent in that type of capitalization outweigh any evidence of its apparent usefulness.

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50. Sections 27(2) and 29 respectively.

51. S.O. 1874, 37 Vict. c. 35, s. 22.

52. The Canada Corporations Act, by its terms, does not prohibit voteless common shares; however, Departmental practice is to refuse incorporation on the basis of a share capital, the holder of any share of which is deprived of the right to vote.

53. Jenkins Report, paras. 123-140.

54. Jenkins Report, para. 123.

55. Professor L. C. B. Gower and two other distinguished members of the Jenkins Committee appended a Note of Dissent to the Jenkins Report, which Note sets out the significant objections to non-voting common shares.

CHAPTER V

Share Capital

SECTION 2.

Purchase by a Company of its Own Shares.

5.2.1. The Ontario Act provides that if a company has more than one class of shares, one class shall be common shares designated as such.[56] The other class or classes of shares shall be preference shares but need not be designated as preference shares. If a company has more than one class of shares, the letters patent or supplementary letters patent must confer on the other class or classes of shares (which must be preference shares howsoever designated) some preference or right over the holders of the shares of the other classes.[57] The charter of a company may authorize the company to purchase preference shares for cancellation or, at its option, to redeem all or any part of any class of preference shares.[58] However, preference shares without par value cannot be made subject to purchase for cancellation or redemption.[59] Where preference shares with a par value are to be redeemed or purchased for cancellation, the maximum price that can be paid by the company on the redemption or purchase for cancellation is (except in the case of open-end investment companies, sometimes referred to as "open-end mutual funds") the amount paid up on the shares together with unpaid dividends and a premium which, under the Regulations[60], cannot exceed 20% of the amount paid up thereon. Preference shares cannot be redeemed or purchased for cancellation if the company is insolvent or if the redemption or purchase would render the company insolvent.[61] Where preference shares are purchased for cancellation or redeemed, they are thereby cancelled and cannot be re-issued; the authorized and the issued capital of the company are thereby decreased.[62]

5.2.2. Accordingly, the Act permits the creation of shares which can be purchased for cancellation or redeemed by the company, but any such shares must be preference shares (howsoever designated), that is to say, they must carry some preference or right over the holders of shares of another class, either preference or common. Redemption or purchase for cancellation of preference shares is treated by the Act as a form of return of capital to the shareholder and, for this reason, the redemption or purchase price is limited by a Regulation under the Act to 120% of the capital which has been paid to the company in respect of such shares.

5.2.3. In 1887 the House of Lords decided in the leading case of *Trevor v. Whitworth*[63] that a limited company could not purchase its own shares:

> "Paid-up capital may be diminished or lost in the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business."

When *Trevor v. Whitworth* was decided, the principle of limited liability for companies, which was introduced into the United Kingdom Companies Act only in 1855, was a relatively new concept, and this no doubt influenced the House of Lords in protecting the position of creditors. It is to be noted that the *Trevor v. Whitworth* rule is not founded on *ultra vires* or lack of capacity but on the quite different ground that the transaction is illegal or unlawful.

5.2.4. Should a company be permitted to purchase its own common shares? It has been necessary for the Committee to determine whether or not the rule of law in *Trevor v. Whitworth* should continue to apply in Ontario so as to prohibit the purchase by companies of their own common shares. Over fifty years of experience in Ontario with redeemable preference shares and the experience in the United States with the right to purchase common shares would indicate that, provided adequate safeguards exist, there need be no apprehension concerning the protection of the rights of creditors and others in permitting companies to purchase their shares. It should be noted that the prohibition derived from *Trevor v. Whitworth* is widespread, prevailing not only in the United Kingdom but also in all the jurisdictions in Canada and all the jurisdictions in Australia as well as in New Zealand and the Union of South Africa.

5.2.5. The traditional opposition to abolishing the rule in *Trevor v. Whitworth* was expressed by the Jenkins Committee as follows:

> " 167. The case of *Trevor v. Whitworth* (1887) 12 App. Cas. 409 established that it is unlawful for a limited company to purchase its own shares, such a purchase being regarded as a reduction of its share capital. There is now a statutory exception to this rule in the form of section 58 of the Act, which permits a company to redeem preference shares but imposes safeguards which are designed to ensure that the amount of the issued share capital is preserved intact. In the United States there is no general rule prohibiting limited companies from buying their own shares and we have considered whether this general rule should be retained in our law. In the opinion of our American witnesses the power enjoyed by companies

in the United States has not led to abuse and it is useful for a number of purposes. An American company wishing to provide its employees with shares as part of a bonus plan or a profit sharing scheme, or to acquire other companies, will often accumulate a sufficient number of its own shares by purchase in preference to issuing new shares and thereby unnecessarily increasing its issued share capital. As companies in the United States are generally free to reduce their share capital without the consent of the Court, this power for a company to buy its own shares also makes it possible to effect a selective reduction of capital, the shares of those members who wish to sell them being bought by the company and then cancelled; members of small companies wishing to retire are often bought out in this way. If a company buys its own shares and does not cancel them, those shares may be re-issued, but in the meantime no votes may be cast and no dividends may be paid in respect of them. Our witnesses pointed out, however, that the case law of the United States imposes very strict liabilities on directors and they considered that this would deal adequately with any abuse of the power by a company or its directors.

" 168. In our view, if the Companies Act were amended to give a limited company a general power to buy its own shares it would be necessary to introduce stringent safeguards to protect both creditors and shareholders. We think it would be possible to devise effective safeguards and we do not think they need to be unduly complicated. On the other hand, we have received no evidence that British companies need this power and the relatively few witnesses who offered any evidence on this matter were almost unanimous in opposing the introduction of a general power for companies to buy their own shares. The power might occasionally be useful when a minority of the members of a small company whose shares were not readily marketable wished to retire from the company and the other members were unable or unwilling to buy their shares at a fair price; we doubt if such a power would often be exercised for this purpose since it would usually give rise to a surtax assessment in respect of past profits of the company still undistributed and, in cases where tax difficulties can be overcome, a quasi-purchase of the shares of the company can be, and in practice is, carried out by the machinery of a reduction of capital by repaying those shares at a premium. We have therefore reached the conclusion that there is no justification for the general abrogation of the familiar rule that a limited company may not buy its own shares; indeed, we think that the rule should be expressly stated in the Act."

5.2.6. As the Jenkins Report indicates, in the United States there is no general rule prohibiting companies from buying their own common

shares. In fact, the opposite appears to be the case: the company law statutes of every one of the United States, either expressly or impliedly, recognize the right of a company to purchase its own common shares subject to certain restrictions pertaining to solvency, the existence of earned surplus or other safeguard measures.

5.2.7. The *Trevor v. Whitworth* rule has been extended in many jurisdictions by statutory provisions which preclude a company, with certain exceptions, from being a shareholder of its own holding company or from providing financial assistance for the purchase of its own shares.[64] The weakness of the rule is, however, pointed up by an analysis made by a leading author who stated[65]:

> "(1) There is no requirement that shares must be of a reasonable nominal value and that part of this value must be left uncalled . . .
>
> (2) There is equally no requirement of a minimum paid-up capital . . .
>
> (3) Since shares may be issued for a consideration other than cash, and since the courts will not normally investigate the adequacy of the consideration, there is not even any assurance that the company ever received assets equivalent to the nominal value of its issued capital.
>
> (4) Even if the capital has been raised, the law cannot ensure that it is not lost in subsequent trading; at the most it can prevent its being repaid to the members . . .
>
> Having regard to these weaknesses, it may well be that these rules have outgrown their usefulness just as the *ultra vires* doctrine has."

5.2.8. There are many legitimate and useful reasons for a company wishing to purchase its own shares. For example, companies may wish to purchase outstanding common shares in order to provide for incentive, bonus or stock option plans without being required to extend their equity base to provide the required shares. Purchase of outstanding common shares is a feasible method whereby a company could contract its equity base as the financial requirements of the company may dictate. The right to purchase common shares could also facilitate mergers and acquisitions in some cases and certainly provides a much needed flexibility for closely-held companies and their shareholders in the event of the death or retirement from the business of one of the principal shareholders.

5.2.9. The Committee therefore recommends that the Ontario Act be amended so as to effect the abolition of the rule in *Trevor v. Whitworth* and recommends that provisions be enacted comparable substan-

tively to Sections 513, 514 and 515 of the New York Business Corporation Law.[66] The effect of this recommendation, if implemented, would be that a company may, subject to any restrictions contained in its charter, purchase its own common shares out of surplus unless the corporation is insolvent or would thereby be made insolvent. Further, companies would be permitted to purchase their outstanding common shares out of capital (subject to the solvency test) if the purchase is made for certain specified purposes such as eliminating fractions of common shares or collecting or compromising indebtedness to the company. Outstanding common shares which are thus re-acquired by a company may either be retained as "treasury shares" or cancelled by the directors, except that common shares so re-acquired out of capital shall be cancelled upon re-acquisition.

5.2.10. The Committee, however, recognizes the distinction which differentiates a purchase by a company of its own common shares at values which reflect the net worth of the company from the purchase or redemption of preference shares at prices which equate the amount paid up thereon plus a premium of a limited amount. It is therefore recommended that the revisions to the Act should provide that the power of a company to purchase its outstanding common shares shall be exercised only by the directors acting in good faith and in the best interests of the company. Violation of the statutory restrictions on the right to purchase would give rise to liability on the part of directors or shareholders who authorized or received the payment of purchase money for common shares acquired in violation of the statutory safeguards. Because a company's trading in its own shares can be said to be a form of "insider trading", the Committee further recommends that Section 86 of the Act should be amended to require the disclosure, in the balance sheet or a note thereto, of the dates of purchase and sale by the company in the year of any equity shares carrying voting rights under all circumstances and the prices at which such purchases and sales were made.

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56. Section 26.
57. Section 27(1).
58. Section 27(2).
59. Section 27(4).
60. O. Reg. 61 s. 32.
61. Section 27(12).
62. Section 27(13).
63. (1887) 12 App. Cas. 409.
64. In the Ontario Act, Section 94 and Section 23 respectively.
65. Gower, supra at 114 et seq.
66. See Appendix B for these provisions of the New York Business Corporation Law.

CHAPTER V

Share Capital

SECTION 3.

Mutual Fund Shares.

5.3.1. The open end investment company or "mutual fund" is now in common use throughout Canada. While the provisions of the Ontario Act do not prohibit the incorporation of a company with share capital appropriate to a mutual fund, the present provisions of the Act limit the payment of the redemption price for shares purchased by the mutual fund at the instance of the holders thereof to redemption out of a fund established for such purchase at a price "as near as may be to the actual value thereof".[67] This restriction is not compatible with the structure of the share capital of most mutual funds with the result that the great majority of mutual funds have been incorporated under the Canada Corporations Act (or its predecessors) which in 1965 was amended to provide specifically for "mutual fund shares".

5.3.2. In order to facilitate the incorporation of open-end investment companies or mutual funds under the laws of Ontario, the Committee recommends that the Act be amended to include provisions comparable to those enacted in the Canada Corporations Act in 1965[68] providing specifically for "mutual fund shares". Such amendments would eliminate the technical difficulties experienced under the Ontario Act in the past and would enable the ready incorporation in Ontario of companies having the particular type of share capital appropriate to the mutual fund.

5.3.3. The Committee's recommendation in this Section is essentially of a technical nature and does not, of course, touch upon the difficulties which may exist concerning the marketing of mutual fund shares, a subject which the Committee did not consider to be within its terms of reference.

67. Section 27(6).
68. Section 12A.

CHAPTER VI

Transfer of Shares

SECTION 1.

Provisions as to Share Transfer in the Ontario Act.

6.1.1. A share of a company has been defined as " . . . an aliquot separate integral part of the authorized capital of a company".[69] As a fractional part of the capital, a share confers upon the holder rights to a proportionate part of the assets of the company, whether by way of dividend or on distribution of assets on winding up. The company's assets, however, are the property of the company; the shares of the company are the property of the shareholders. A share certificate, on the other hand, is merely evidence that the person in whose name the certificate is registered is a shareholder of the company. As stated in the Ontario Act, a share certificate is *prima facie* evidence of the title of the shareholder to the shares represented thereby. A share has been described as " . . . a bundle of several rights and liabilities".[70] Such rights include the right to duly declared dividends, the right to vote, rights on winding up to participate in the distribution of assets. In addition, the Act itself confers certain individual rights on shareholders arising from ownership of shares: for example, the right of a shareholder to a share certificate in respect of the shares held by him, the right to receive notice of meetings of shareholders, the right to receive financial statements, the right to inspect minutes of meetings of shareholders and certain documents and registers required to be maintained pursuant to the Act and the right to apply to the court for the winding-up of the company.

6.1.2. Shares of a company are personal estate and transferable as such by the shareholder. Indeed, when joint stock companies were established in the United Kingdom, the great object was that shares should be capable of being easily transferred. Share certificates, on the other hand, are not negotiable instruments; they may pass by delivery but subject to the equities. The provisions of the Ontario Act dealing with transfers of shares are largely derived from the United Kingdom Companies Acts and can fairly be said to constitute a "book stock" system of transfer roughly comparable to a land registration system. The Act states that shares of a company are transferable "on the books of the company" subject to such conditions and restrictions as are prescribed in the Act or in the charter. A "private company" is, by statutory definition, a company as to which by charter the right to transfer shares is restricted. To a large extent, therefore, this Chapter is concerned with "public" rather than "private" companies as those terms are presently used in the Act.[71]

6.1.3. The Committee considered how these "bundles of rights" are made transferable under the existing provisions of Ontario law in order to ascertain if the present methods of transferring shares are adequate to meet the needs of present day stock exchange techniques and the demands of the financial community. The study indicated that, as a practical matter, the existing share transfer system works reasonably well, largely, however, because the brokerage community treats share certificates in "street form" as though they were in fact negotiable instruments.[72] In other words, the existing practices depend on the assumption that the certificate passes title to the shares which it represents. This assumption is encouraged by the by-laws and rules of The Toronto Stock Exchange which state, in effect, that the delivery of certificates in street form shall be deemed to be good delivery. To the extent, therefore, that Ontario can be said to have (to use the American phrase) a "negotiable instruments law for investment securities", it is because of the rules and practices of The Toronto Stock Exchange and the brokerage community. In the market place, it is frequently inconvenient or impossible for each of successive transferees of shares traded in the listed or unlisted market to become registered as shareholders. While share certificates are not negotiable instruments, Ontario law is to the effect that share certificates properly endorsed in blank by the registered owner are, in the hands of a lawful holder, recognized as property, rights and interests which entitle the possessor to be registered as owner. The holder for the time being of such a certificate takes not the property in the shares but a title, legal and equitable, which will enable him to vest himself with the shares without the risk of his right being defeated by any other person deriving title from the registered owner. However, the holder of any such certificate takes the shares represented thereby subject to any infirmity in the title of the person from whom he acquires them so that if the share certificates were lost by or stolen from the owner the subsequent holder of the certificate is vested with no title whatsoever to the shares represented thereby.

6.1.4. The Committee has concluded that the provisions in the Ontario Act relating to transfers of shares are at variance with the practices in the financial community and should be substantially changed in order to eliminate the anomalies and inconsistencies which exist between the applicable law and the prevailing practices. In order to lay the ground work for the Committee's recommendations in this regard, it is necessary to examine in some detail the present statutory provisions relating to the transfer of shares of Ontario companies.

6.1.5. The relevant provisions of the Ontario Act are Sections 37 to 51 inclusive and their principal features may be summarized as follows. Every company is required to keep a register of transfers in which all transfers of shares and the date and other particulars of each transfer

are set out. Branch registers of transfers are authorized and the registration of a transfer of a share on a branch register of transfers is a valid registration for all purposes. A company may appoint a transfer agent and one or more branch transfer agents to keep the register of transfers and any branch registers of transfers. Every shareholder is entitled to a share certificate in respect of the shares held by him and such certificate is *prima facie* evidence of the title of the shareholder to the shares represented thereby. Shares are transferable "on the books of the company" subject to such conditions and restrictions as may be prescribed in the Act or the charter of the company. The Act further provides that no transfer of shares (subject to certain exceptions not here material) is valid for any purpose whatsoever until registration thereof has been duly made in the register or branch register of transfers "save only as exhibiting the rights of the parties thereto toward each other . . ." To this rule, however, an important exception is made in that the Act further provides that notwithstanding the provision last referred to, where fully paid shares are listed on a recognized stock exchange, delivery of a certificate for such shares with a duly executed instrument of transfer endorsed thereon or accompanying it constitutes a valid transfer of the shares represented by such certificate. The directors may refuse to permit the registration of a transfer of shares on the books of the company (presumably whether or not the shares are listed on an exchange) for the purpose of notifying the registered shareholder of the "application for such registration".

6.1.6. This share transfer system contemplated by the Act is, plainly, an old fashioned "book stock" or registration of title concept which seems, historically, to have evolved in the 19th century as a result of the refusal of the law to recognize a company share as a chose in action and a share certificate as a negotiable instrument. Nothing useful is said in the Act as to the method of assignment or transfer of shares as between the transferor and the transferee or of their respective rights and liabilities except that some instrument of transfer is contemplated by the statute.

6.1.7. Numerous substantial difficulties arise from the share transfer procedures contemplated or required by the Act, including the following: the courts have been disinclined to interpret Section 49(2) in accordance with the literal meaning of the language, that is, the courts have not held, as the statute provides, that delivery of certificates for shares listed on a recognized stock exchange constitutes valid transfer of the shares represented by such certificates[73]; the statutory concept is that shares of companies are transferable only "on the books of the company", a concept which is ignored in practice so far as shares represented by street form certificates are concerned; the company, as the unwilling custodian of the transfer records, is, under certain circum-

stances, made liable for recording "improper" transfers whereas the liability in most cases should be ascertained as between the transferor and the transferee and not between third parties and the company which is not a party to the transfer transaction but merely the custodian of the transfer books; the role and purpose of the instrument of transfer or power of attorney is not made clear in the statute and accordingly its function is uncertain and obscure; no statutory guidance is given to the effect and scope of endorsements of certificates or guarantees of endorsements nor are guidelines available for transfer agents and the financial community generally as to share transfers involving fiduciaries or minors.

6.1.8. The Committee has concluded that the law should be brought in line with the requirements of the changing stock exchange and transfer agency practices and adapted to the developing technological changes which have antiquated the concept of shares being transferred "on the books of the company". The legal relationships between transferors and transferees, between brokers and transfer agents and between the company and third parties should be clarified. In an honest effort to arrive at equitable solutions in particular factual situations concerning share transfers where one or more innocent parties are usually involved, courts have failed to develop adequate judicial guidelines in determining the questions of legal relationships among the various parties to the share transfer. The Committee has further determined that the Ontario Act should recognize the realities of the share transfer transactions as to shares listed on The Toronto Stock Exchange and as such transactions occur in the unlisted market in Ontario. There is, moreover, no reason to limit the Committee's recommendations to share transfers only—legal reform is required in respect of security transfer transactions of all kinds. The Committee has concluded that the enactment of a comprehensive code to govern and regulate all corporate security transfer transactions is desirable and in the public interest.

6.1.9. In making the recommendations which follow the Committee does not thereby intend to intrude upon or deal in any material way with the essential legal attributes and characteristics of the company share, the nature of which is referred to in paragraph 6.1.1.

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69. Fraser & Stewart, supra at 179.
70. Palmer, supra at 281.
71. See, however, the recommendations in Section 1 of Chapter II.
72. A "street form" certificate in this sense is a certificate registered in the name of a stock exchange member and duly endorsed or a certificate registered in the name of any other person or firm and duly endorsed with endorsement guaranteed by a stock exchange member.
73. *Chartered Trust and Executor Company and Cochenour-Willans Gold Mines Limited v. Pagon and Indemnity Insurance Company of North America*, [1950] O.R. 662.

CHAPTER VI

Transfer of Shares

SECTION 2.

The Uniform Commercial Code—Article 8.

6.2.1. The Uniform Stock Transfer Act has been incorporated into the law of the great majority of the United States, thereby enacting a code as to corporate security transfers which provides a "negotiable instruments law for securities" which, among other features, accord share certificates some of the characteristics of negotiable instruments. This useful Uniform Act, however, is in the course of being replaced in the various United States by The Uniform Commercial Code—Article 8 which relates to a wider field of investment securities and which extends the concept of negotiability of such securities. There is no reason why The Uniform Commercial Code—Article 8 could not be appropriately adapted to the language and context of the Ontario Act and the Committee therefore recommends that the Act be amended by deleting the existing provisions relating to share transfers and share certificates and substituting therefor a corporate securities transfer code modelled closely after Article 8 of The Uniform Commercial Code with appropriate changes of terminology. The code should be included in the Act as a separate Part.

6.2.2. The adoption of such a securities transfer code should not, it is submitted, interfere adversely with the developed practices of Canadian stock exchanges and the financial community generally. In fact, one of the effects of the adoption of such a code would be to bring the statutory law in line with such practices and, in the opinion of the Committee, would significantly upgrade the prevailing practices to the mutual benefit and advantage of the investing public, the stock exchanges, and transfer agents and brokers. The code would broadly define the "securities" to which it applies and would state that such securities would be negotiable instruments. "Security" would be defined with the objective of including shares, bonds and all other types of documents commonly traded or dealt in as investments. The definition would be functional rather than formal and designed to include anything which securities markets, whether stock exchanges or the "over-the-counter markets", are likely to regard as suitable for trading, except commodity futures.

6.2.3. The Uniform Commercial Code—Article 8 as modified by officially recommended amendments is annexed to this Report as Appendix C. It is recommended that the new Part to be included in the Ontario Act, modelled after Article 8, should consist of 4 Divisions. The first Division would incorporate the required definitions of terms

and presumptions and certain general matters. The second Division would relate to the company as the issuer of the securities and would set out the duties, obligations, rights and defences imposed upon or available to the company in respect of transfers of securities, including provisions with respect to restrictions on transfer and the effect of unauthorized signatures and warranties of authenticating transfer agents, registrars or trustees. The third Division would state the legal duties and responsibilities as between transferors and transferees of securities, the effect and scope of warranties, endorsements and guarantees and statements as to what constitutes delivery and as to the role of the broker. The fourth Division would relate to the registration of transfers of securities and would define the duties of the company and its transfer agent or branch transfer agent, specifying those situations in which liability could be incurred in respect of registrations of transfers and stipulating when a duty to inquire arises and what treatment is to be accorded to lost, stolen or destroyed securities.

CHAPTER VI

Transfers of Shares

SECTION 3.

Supplementary Recommendations.

6.3.1. A newly developing and commercially useful method of transferring or pledging securities, particularly among brokers and banks but not necessarily so limited, is shortly to be put into effect at the New York Stock Exchange. This is a central depository system, in the case of the New York Stock Exchange called Central Certificate Service, operated by a Stock Clearing Corporation, which is a wholly-owned subsidiary of the Exchange. This system of transfer has evolved from a series of pilot studies conducted by the New York Stock Exchange and has been under study by The Toronto Stock Exchange. The new transfer method is intended to facilitate the increasing volume of exchange transactions and in doing so eliminates physical deliveries of share certificates and reduces problems arising from loss, theft and mutilation of share certificates. The system permits a mechanized clearing house where purchases and sales of securities are reflected by accounting entries and not by physical deliveries. By recommending the enactment of an adapted Uniform Commercial Code—Article 8 in Section 2 of this Chapter, the Committee is thereby recommending the necessary legislative changes to permit the establishment of a central depository system and Stock Clearing Corporation inasmuch as the 1962 officially recommended amendments to Article 8 introduce into Article 8 the necessary provisions to give effect to the new transfer of securities system. The system may best be described by quoting from §8-320 of the Uniform Commercial Code—Article 8:

"(1) If a security

(a) is in the custody of a clearing corporation or of a custodian bank or a nominee of either subject to the instructions of the clearing corporation; and

(b) is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation or custodian bank or a nominee of either; and

(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the

account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.

(2) Under this section entries may be with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number or the like and, in appropriate cases, may be on a net basis taking into account other transfers or pledges of the same security.

(3) A transfer or pledge under this section has the effect of a delivery of a security in bearer form or duly endorsed in blank (Section 8-301) representing the amount of the obligation or the number of shares or rights transferred or pledged. If a pledge or the creation of a security interest is intended, the making of entries has the effect of a taking of delivery by the pledgee or a secured party (Sections 9-304 and 9-305). A transferee or pledgee under this section is a holder.

(4) A transfer or pledge under this section does not constitute a registration of transfer under Part 4 of this Article.

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries nor the liabilities or obligations of the clearing corporation to any person adversely affected thereby."

The terms "clearing corporation" and "custodian bank" are defined in Article 8.

6.3.2. The Ontario Act requires every certificate representing preference shares to state thereon in legible characters the share provisions attaching to the particular preference shares of that class. In view of the prolixity of preference share provisions, this statutory requirement has long since ceased to be meaningful, if it ever was, both in respect of closely-held and publicly-held companies. Article 8-202 of the Uniform Commercial Code which the Committee recommends for adoption in Ontario states that even against a purchaser for value and without notice, the terms of a security include those stated on the security and those made part of the security by reference to another instrument, indenture or other document or to a statute, etc. We recommend that this provision be revised to include the technique employed in the new Manitoba Companies Act[74] to the effect that a statement shall be inscribed on each share certificate that there are conditions and restrictions attached to the particular class of shares and that the full text thereof is obtainable on demand, and without fee, from the secretary of the company.

6.3.3. Similarly, it is to be noted that the adoption of Article 8-204 will introduce the principle that "unless conspicuously noted on the

security, a restriction on transfer imposed by the share, even though otherwise lawful, is ineffective except against a person with actual knowledge of it". If the Committee's recommendations in Chapter II, Section 1 are implemented, thus abolishing the concept of the "private company", restrictions on transfers of shares will, as a result of the recommendations in this Section, be required to be "noted conspicuously" on share certificates in order to give notice of the fact that the charter of the company contains restrictions on the free transferability of shares.

6.3.4. The Committee also recommends an amendment of the definitions of the terms "books" and "registers" in the Ontario Act so as to permit the use of mechanical and electronic means of record-keeping for companies, including registers of transfers of shares.

74. S.M. 1964 (2d. Session) c. 3, as amended.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 1.

The Role of the Director.

7.1.1. The Ontario Act provides that the "affairs of every corporation shall be managed by a board of directors howsoever designated". This is, historically, a classic statement of the role of the directors in the corporation law of many jurisdictions. However, this terse description of the functions of directors shows signs of age and, in the Committee's opinion, should be amended to make it more applicable to the modern business corporation. The provision would more accurately read as follows:

> "The business and affairs of every corporation shall be managed or supervised by a board of directors howsoever designated."

7.1.2. Having established that the business and affairs of an Ontario company are to be managed or supervised by the directors, two most difficult and fundamental legal questions are then encountered which go to the basic principles of corporation law. First, what relationship, in law, exists or should exist between the directors and the company, between the directors and the shareholders and between the directors and the creditors of the company or other persons with whom the company has dealings? Secondly, what, in law, are or should be the duties and responsibilities of directors in the exercise of their statutory office?

7.1.3. The Companies Acts of the various Anglo-Canadian jurisdictions have traditionally been silent on both of these fundamental questions. There exists, however, a maze of relevant jurisprudence from which a series of more or less well-established principles or propositions have emerged. For example, it is clear that directors, as such, are not employees or servants of the company. Conversely, directors have been judicially described as trustees or agents of the company—trustees of the company's assets and agents in the transactions which they enter into on behalf of the company. This latter proposition has been qualified by English courts, however, by the reservation that to describe a director as a trustee or an agent of the company is not exhaustive of the duties and responsibilities of a director "but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered."[75]

7.1.4. The legal relationships between the director and those with whom he deals are reasonably clearly defined and the fewest difficulties,

from the public interest standpoint, arise in this area of consideration. The director is clearly a fiduciary and for that reason in the exercise of his powers he is bound to act with the utmost good faith for the benefit of the company.[76] As a fiduciary he is accountable to the company for any profit or gain realized from any dealings with the company's assets or for any advantage he may secure by reason of his office. It is equally clear in law however that, barring special circumstances, the director has no fiduciary relationship with the shareholders of the company as such, either collectively or individually[77] except to the limited extent now provided in Section 71d of the Ontario Act whereby a director, as an insider of a company, can incur liability to certain persons (including shareholders) as a result of improper transactions in the securities of the company. Nor is the director a fiduciary in relation to the company's creditors or to strangers with whom the company has dealings.

7.1.5. The study and research carried out by the Committee leads us to conclude that the problem areas concerning the role of the director in modern commercial society arise from the present uncertainty of defining the standard of probity, care and diligence with which the director must discharge the duties and responsibilities of his office. There does not seem to the Committee to be any impelling need for legislative rules to define the fiduciary character of the director's role especially now that the significant problem of liability for and reporting of directors' insider security transactions has been dealt with by the Ontario Legislature.[78] We must return, however, to the second fundamental question posed above, namely, what, in law, are or should be the duties and responsibilities of directors in the exercise of their office? The difficulties in ascertaining, with the commercially desirable degree of definity, the scope of the director's duties in carrying out his role as a fiduciary to his company is aptly described in a passage from the judgment of Romer J. in *In Re City Equitable Fire Insurance Company Limited*:[79]

> "It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee of a will or of a marriage settlement. It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ

from those of a director of another. In one company, for instance, matters may normally be attended to by the manager or other members of the staff that in another company are attended to by the directors themselves. The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff. The manner in which the work of the company is to be distributed between the board of directors and the staff is in truth a business matter to be decided on business lines . . .

"In order, therefore, to ascertain the duties that a person appointed to the board of an established company undertakes to perform, it is necessary to consider not only the nature of the company's business, but also the manner in which the work of the company is in fact distributed between the directors and the other officials of the company, provided always that this distribution is a reasonable one in the circumstances, and is not inconsistent with any express provisions of the articles of association. In discharging the duties of his position thus ascertained a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence."

7.1.6. Assuming the enactment into Ontario law of a revised Section 296 as is recommended in paragraph 7.1.1, the authority of the directors will be stated to extend to the management or supervision of the management of the business and affairs of the company. Some of the director's duties embraced within this authority are specified in the Act. Thus, the directors initiate and enact by-laws which, on confirmation by shareholders, regulate the internal affairs of the company in all particulars; the directors initiate and pass certain resolutions which, on confirmation by shareholders, become special resolutions which of themselves authorize a range of important corporate acts; shares in the capital of the company may be allotted and issued only by the directors; the directors may borrow money pursuant to duly enacted and confirmed by-laws; and the directors declare any dividends which the company pays to its shareholders. As is illustrated by the above quoted passage from the judgment of Romer J. in *In Re City Equitable Fire Insurance Company Limited,* however, these statutory powers or duties by no means exhaust the scope of the office of the director: "It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise".

7.1.7. The Jenkins Committee adopted the view of the General Council of the Bar of the United Kingdom in deciding that any attempt by statute to define the duties of directors more clearly would involve the risk of hiatuses or gaps which might make it more difficult to determine in any particular set of circumstances what those duties were. The

Jenkins Committee recommended against the "codification of the existing law". We do not find it necessary to determine whether or not we are in agreement with the Jenkins Committee in this respect for in the Committee's view codification of the existing law would not, in any event, provide the solutions to the problems confronting directors, shareholders and the investing public generally arising from the role of the director in the modern business corporation. The Committee does agree however, that it would be folly, for example, to attempt to codify the principles which the courts have developed from the fiduciary concept in imposing implied restrictions on the exercise of a discretion of a director in the discharge of his duties. Nor would it seem possible to codify into statutory principles the guidelines used by the courts in determining what constitutes a secret profit or an abuse of confidence on the part of a director. Since the director is both an agent and "some kind of" a trustee, the courts should remain free, unfettered by a codification of principles, to develop from the law of agency and the law of trusts the duties and responsibilities of directors arising from the multitude of varying factual situations which can exist. The development of company law has never been confined to statute and it would be unwise to deprive the future development of the law concerning the role of the director of the past and future benefits of jurisprudential opinion.

75. *Imperial Hydropathic Hotel Company, Blackpool, v. Hampson* (1882) 23 Ch. D. 1 at 12.
76. *The Sun Trust Company Limited v. Wilfrid Bégin et al.* [1937] S.C.R. 305.
77. *Percival v. Wright* [1902] 2 Ch. 421.
78. An Act to Amend The Corporations Act, S.O. 1966 c. 28.
79. [1925] Ch. 407 (C.A.) at 426 et seq.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 2.

Standard of Conduct and Care Required of Directors.

7.2.1. The law is clear as to what duties of good faith are owed by the director to the company arising from his fiduciary relationship. What is not clear, however, is the proper measure or standard of the duties of probity, care, diligence and skill owed by the director to the company in the discharge of his office. Here the trustee analogy breaks down[80] and even the honest, well intentioned director is left to flounder in a sea of murky jurisprudence. Directors manage or supervise the management of businesses. As such, so far as commercial enterprises are concerned, they cannot owe the duties of care, diligence and skill owed by trustees—as business managers they must be risk-takers seeking a profit for the company and its shareholders.

7.2.2. In researching and studying the role of the company director in contemporary commercial society, both with respect to the closely-held corporation and the publicly-held corporation, the Committee has determined that it is not the director's fiduciary relationship to the company which is unclear in the law, nor do the precise scope or nature of his duties and responsibilities need codification. Leaving aside the important matter of enforcement of remedies as to which much is said below, the question ultimately faced by the Committee was simply this: what, in law, is the standard of conduct and care which should prevail in the board room? The Committee is of the opinion that the Act can and should contain a clear statement of that standard of behaviour owed by directors in performing their complex and multifarious duties. The standard should be plain enough to be acceptable and practised in the board room and to be enforceable in the courts. It follows, of course, that if the Committee's recommended legal standard is to develop into an accepted professional code of ethics, it must appeal to the fair minded director and be compatible with his role as a manager and risk-taker.

7.2.3. The Committee therefore recommends that the Ontario law be amended to include a provision substantially as follows:

> "Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and in connection therewith shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances."

7.2.4. This legal standard of conduct and care upgrades the existing standards as laid down in the decided cases[81] and should satisfy the objectives expressed in paragraph 7.2.2. However, to stop here would accomplish little since the existing remedies available to the company and its shareholders to enforce the recommended standard of behaviour are technical, procedurally complex and, in the Committee's opinion, inadequate to protect the interests of shareholders. We therefore consider next the intimately related topic concerning the role of the director: by whom and by what means shall this legal standard of conduct and care, this director's code of ethics, be enforced?

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80. Gower, supra, at 472.
81. See In Re *Forest of Dean Coal Mining Company* (1878) 10 Ch. D. 450 at 452; Re *Owen Sound Lumber Co.* [1917] 38 O.L.R. 414 (C.A.) at 421 et seq.; *Northern Trust Co. v. Butchart* (1917) 35 D.L.R. 169; In Re *City Equitable Fire Insurance Company Limited* [1925] Ch. 407 (C.A.) at 629; *Western Ontario Gas Company Limited v. Aitkens et al* [1946] O.R. 661.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 3.

Enforcement of Duties and Responsibilities of Directors.

7.3.1. It has already been observed (paragraph 7.1.1) that under the Ontario Act the management of the company is vested in the directors. The directors are authorized and empowered to manage the company without interference by the shareholders and, in the absence of illegality, fraud or oppression of minority shareholders' interests, the courts will not interfere with management. The rule of non-interference in the internal affairs or disputes of companies is a deep-seated principle of Anglo-Canadian corporation law. The rule is no more than a synonym of the principle that since the internal affairs of a company are within the jurisdiction of the directors or a majority of the shareholders, as the case may be, they are outside the jurisdiction of the courts.

7.3.2. The rule of judicial non-interference in corporate affairs has exerted a strong influence on the development of the rights, or lack of rights, of the minority shareholder and it might therefore be useful briefly to trace the development of the rule. Partnership disputes came under the jurisdiction of the English Chancellor because of the superior accounting machinery available in Chancery and because of the equitable nature of partnership interests. Thus, the Chancellor's original jurisdiction in the case of companies was based upon the unincorporated joint stock company which was organized by a trust created by a deed of settlement. These unincorporated joint stock companies were, at law, merely partnerships although in view of the very large number of "members" holding shares in the "joint stock" they bore little resemblance to the normal commercial partnership. This unincorporated joint stock company fell to the jurisdiction of Chancery where partnership rules were applied. The joint stock company, however, in which ownership was clearly separated from management and control, created problems in the Chancery courts quite different from those arising from ordinary partnerships. It was in 1843, at this very early stage in the development of the principles of corporation law, that the celebrated case of *Foss v. Harbottle*[82] was decided. In that case, the minority shareholders alleged that the company had a claim in damages against certain of the directors by reason of the fraudulent acts of those directors. It was held that the particular acts of the directors could be confirmed by the majority of the shareholders and as the majority, in general meeting, had not yet expressed its will, the court would not interfere. The majority of shareholders was free to decide what was for the benefit of

the company. The plaintiffs, therefore, had no standing to sue in the name of the company and were non-suited on the procedural point. The judgment is clearly premised on the desirability of majority rule in the direction of a company's affairs. The judgment is also said to stand for the principle that the courts will not interfere in the internal disputes of corporations. In addition to these substantive rules, the judgment holds that in respect of a wrong done to the company the company is the proper plaintiff in an action to seek redress. This procedural aspect of the decision has had widespread ramifications which are discussed below.

7.3.3. It is a fundamental principle of common law that only a person who has suffered a wrong may maintain an action in respect thereof. This principle, in its most elementary sense, is an essential ingredient in the so-called Rule in *Foss v. Harbottle*—a rule not peculiar to company law but common to all civil litigation. When applied to company law, this seemingly simple rule has given rise to a number of complex problems as difficulties arise immediately one speaks of a wrong done to a corporation, for the corporate personality is a legal fiction. A corporation exists as a legal person only as a creature of statute but behind the fiction exist the actual persons whose investment has given the corporation the resources with which it carries on business. While the corporation's personality may be a fiction, as an economic organization it has a reality of its own. It follows, therefore, that a wrong done to a company results in injury to it in a direct and real sense. At the same time, injury has occurred, in an indirect sense, to the shareholders of the company, as the value of their investment may thereby be reduced. Therefore, one of the substantial problems arising out of the Rule in *Foss v. Harbottle* is—who shall determine and instigate what action or proceedings, if any, the company shall take to redress a wrong done to it?

7.3.4. It is absolutely essential to an understanding of the Rule and the difficulties which surround it to understand that under English law the decision whether or not to sue in the corporate name belongs to the general meeting of shareholders where the majority rule applies. The principle of the supremacy of the majority is fundamental to corporation law and is expressly stated in the Ontario Act.[83] The principle is that persons who acquire shares in a company are deemed to have agreed to submit themselves to the decision of the majority at shareholders' meetings in respect of all matters which are within the competence of such meetings. The majority rule principle is significantly strengthened by the further principle that a director is not disqualified in voting as a shareholder on a resolution to approve a contract that he has entered into with the company.[84] In fact, in his capacity *as a shareholder,* he can use his voting power to ratify a breach of his fiduciary duty. Since under United Kingdom law the power to commence proceedings in the com-

pany's name is vested in the shareholders in general meeting, it can readily be seen how the "majority rule" led to the decision in *Foss v. Harbottle.* If the company, as represented by a majority of the shareholders, considers that a wrong has been done to the company, it can bring appropriate action. On the other hand, if the company, as so represented, does not consider that it has been wronged, no proceedings need be taken. The Rule in *Foss v. Harbottle,* based in large part on the principle of the supremacy of the majority, is summarized in the following well known passage from the judgment of the English Court of Appeal in *Edwards v. Halliwell*[85]:

> "The rule in *Foss v. Harbottle,* as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quoestio.* No wrong had been done to the company or association and there is nothing in respect of which anyone can sue. If, on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company or association itself should not sue. In my judgment, it is implicit in the rule that the matter relied on as constituting the cause of action should be a cause of action properly belonging to the general body of corporators or members of the company or association as opposed to a cause of action which some individual member can assert in his own right."

7.3.5. In marked contrast to the law in the United Kingdom, control of the decision whereby a company commences proceedings to seek redress for a wrong done to it resides, in Ontario law, in the board of directors of the company. Putting this statement in another way, there is no means whereby a majority of the shareholders in an Ontario company can authorize an action in the corporate name on behalf of the company against the wishes of the board of directors. In the United Kingdom, residual management power resides in a majority of the shareholders in general meeting; in Ontario residual management power is clearly conferred upon the board of directors as an incidence of the directors' powers to manage the company's affairs. And nothing can be more germane to the management of a company than the decision to sue, or not to sue, on the company's behalf.

7.3.6. This significant distinction between the United Kingdom and the Ontario law considerably confuses the application of the Rule in *Foss v. Harbottle* and the so-called "exceptions" to the Rule, to which reference is made below. If the will of an Ontario company is the will of a majority of the directors rather than a majority of the shareholders, the availability of the "exceptions" to the rule whereby an action can be brought by a shareholder on behalf of the Ontario company to remedy a wrong done to the company is clearly frustrated by the fact that the wrong is likely to have been done by one or more of the directors who themselves, as managers, determine whether or not the suit shall be brought.

7.3.7. The so-called "exceptions" to the Rule in *Foss v. Harbottle,* that is to say, situations that fall outside the Rule in the sense that the courts have held that the majority of shareholders cannot confirm the corporate act in question, are:

(a) an act which is illegal or *ultra vires* the company,

(b) an act which constitutes a fraud against the minority, the wrongdoers themselves being in control of the company; and

(c) a resolution which requires a qualified or special majority vote but which has been passed by a simple majority.

Acts which the majority cannot confirm are acts in respect of which the restrictions of the Rule do not apply and in respect of which actions can therefore be maintained by the minority.

7.3.8. Combining the principles of law referred to above and giving effect to the Rule in *Foss v. Harbottle,* it follows that the directors of an Ontario company are authorized and entitled to manage the company without interference by the shareholders and that, in the absence of illegality, fraud or oppression of the minority, the courts will not interfere with such management. In applying the Rule, the courts have determined not to interfere on behalf of a minority shareholder in such business decisions as: to lease or sell the company's undertaking; to expand the company's business to other countries; to borrow money; to make a voluntary assignment for the benefit of creditors; to amalgamate with other companies; to enter into a contract to buy the property of a majority shareholder. Similarly, the courts have refused to interfere in such intra-corporate matters as the proper appointment and removal of directors and employees, the quantum of remuneration of directors and officers, the making of calls, paying dividends, reducing capital and creating new classes of shares. In refusing to intervene in such cases, Ontario courts have made statements to the effect that it is immaterial that the decision of the majority is improvident, unnecessary for the

purpose of the business or even disadvantageous to a minority of the shareholders. It is a further principle of corporation law that the vote of each shareholder is a right of property which he may exercise "from motives or promptings of what he considers his own individual interest" even if the shareholder is activated by "interest entirely adverse to the interest of the company as a whole".[86] Unlike directors, who are fiduciaries in their relationship to the company, shareholders of a company voting at meetings of shareholders have no fiduciary obligations either to the company or to other shareholders.

7.3.9. As a result of the Rule in *Foss v. Harbottle* and the method by which it has been applied by the courts in conjunction with the other principles of company law noted above, the Ontario Court of Appeal can make the following sanguine statement of the law:[87]

> "He [the applicant for winding-up] is a minority shareholder and must endure the unpleasantness incident to that situation. If he chooses to risk his money by subscribing for shares, it is part of his bargain that he will submit to the will of the majority. In the absence of fraud or transactions *ultra vires*, the majority must govern, and there should be no appeal to the Courts for redress."

The moot question is, when does "unpleasantness" become oppression?

7.3.10. In Section 2 of this Chapter the Committee recommended an amendment to the Ontario Act which would constitute a legal standard of conduct and care required to be met by directors in the exercise of the powers and the discharge of the duties of their office. This statutory code would have the advantage of being known to directors as the norm by which the statute requires them to perform their duties and has the further and significant effect of upgrading the existing standards laid down in the jurisprudence. However, as the Committee stated in that Section, to stop there would accomplish little because of the inadequacy of the remedies presently available to enforce wrongs done to companies by the directors and officers acting as management—an inadequacy which this Section discloses to be largely the result of the application of the old but well-entrenched Rule in *Foss v. Harbottle*. The rights of minority shareholders must be strengthened and the oppressive procedural and substantive effects of the Rule in *Foss v. Harbottle* either mitigated or done away with in their entirety.

7.3.11. In 1945 the Cohen Committee in the United Kingdom recommended that in order to strengthen the minority shareholders in resisting oppression by the majority the court should have, in addition to the power to order a winding-up, power to impose upon the parties to a dispute whatever settlement the court considered just and equitable. The Cohen Committee recommended that the court's discretion be un-

fettered "for it is impossible to lay down a general guide to the solution to what are essentially individual cases". The result was Section 210 of the United Kingdom Companies Act of 1948 which reads as follows:

"(1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself) or, in a case falling within subsection (3) of section one hundred and sixty-nine of this Act, the Board of Trade, may make an application to the court by petition for an order under this section.

(2) If on any such petition the court is of opinion—

(*a*) that the company's affairs are being conducted as aforesaid; and

(*b*) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up;

the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise."

7.3.12. It is not necessary in this Report to analyze the deficiencies of Section 210 or to comment upon the observations made on the Section in the Jenkins Report.[88] It is sufficient for the Committee to state that the very existence of Section 210 is a recognition by the Parliament of the United Kingdom that the rights of minority shareholders were inadequate and that new and different remedies were therefore required to redress wrongs done to the company or to minority shareholders. In our opinion, Section 210 raises as many problems as it lays to rest and, more importantly, is objectionable on the ground that it is a complete dereliction of the established principle of judicial non-interference in the management of companies. The underlying philosophy of Section 210 has an air of reservation and defeatism about it, as if the legislature was unable to offer any solution to the plight of minority shareholders other than abandoning the problems to the judiciary to be dealt with ad hoc on the basis of determining, from case to case, whether or not "the affairs of the company are being conducted in a manner oppressive to some part" of the shareholders.

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82. (1843) 2 Hare 461.

83. Section 79(1)(c); see also *Noble et al. v. Cameron et al.* [1955] O.R. 608 (C.A.).

84. *North-West Transportation Company Limited v. Beatty* (1887) 12 App. Cas. 589 (P.C.).

85. [1950] 2 All E.R. 1064 at 1066 (C.A.).

86. *Pender v. Lushington* (1877) 6 Ch. D. 70 at 76 (C.A.).

87. *Re Jury Gold Mine Dev. Co.* [1928] 4 D.L.R. 735 at 736 (C.A.).

88. Para. 199 et seq.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 4.

The Derivative Action.

7.4.1. The Committee considered the alternatives to a Section 210 approach (to the extent that Section 210 is available to relieve against the Rule in *Foss v. Harbottle*) and concluded that the derivative action is the most effective remedy to enforce the suggested statutory standard of conduct and care to be imposed upon directors in the exercise of their duties and responsibilities. Some definition of terms is useful. A personal action is one which can be maintained by a shareholder to assert a right which is personal to the shareholder. As individual shareholders' rights are frequently collective in character, the personal action will often be a representative form of action in which a shareholder or shareholders sue on behalf of all shareholders having the same interest. In some cases the defendant will be the company and in other cases the defendants will be the directors or officers, whichever is said to have committed the wrong. An example of such a cause of action would be a suit for dividends declared by the directors and not paid by the company, or an action to enforce a pre-emptive right. By way of contrast, a derivative action is one where a minority shareholder or shareholders sue in representative form claiming redress for a wrong done to the company. The wrong having been done to the company, the company is the proper plaintiff in the action but the action may be maintained by shareholders where the "wrongdoers are in control" and fail to seek redress for the wrong which has been done. The action is derivative because the plaintiff's right to sue is secondary in nature and is accorded him on the ground that the true plaintiff refuses or neglects to bring the action. In respect of the derivative suit here under consideration, the company at all times is the injured party and at all times is the true plaintiff even although shareholders are permitted to maintain the action as nominal plaintiffs. The wrongdoers will normally be directors and officers whose misfeasance or inaction has resulted in damage to the company of which they are the managers. The courts have insisted that the plaintiff in a derivative action of this character sue in a representative capacity so that all shareholders will be bound by the judgment, thus forestalling a multiplicity of actions. Because the company is the nominal defendant, but true plaintiff, any decision in the case becomes *res judicata* so far as the company is concerned, thus precluding it from bringing subsequent action on the same cause.

7.4.2. As is well known, derivative actions in company law matters

are common in the various United States and are the subject of statutory attention in a number of important American jurisdictions. In many or most of the United States, the rules of ethics of State and local bar associations apparently permit lawyers to act in civil litigation on a "contingency fee" basis. This has led to the so-called "strike bar" in the field of derivative actions against corporations. Further, plaintiffs frequently threaten to bring derivative actions or in fact commence them solely for the purpose of provoking secret settlements with the companies even in circumstances where the action is not well founded. In the result, the derivative action has achieved a notable degree of unpopularity in Canada and elsewhere. There is no doubt that this unpopularity is merited in many instances as the actions which have been commenced are frequently of an harrassing nature, brought in the hope that a judgment will carry with it a substantial award for lawyers' fees and expenses as is expressly permitted by the statutes of many States. The Committee is satisfied, however, that the undesirable characteristics of the derivative action can be avoided and that the remedy is one which can and should be adapted to Ontario law and practice to serve as an effective procedure whereby corporate wrongs can be put right.

7.4.3. The Committee therefore recommends that the Ontario Act be amended by adding a substantive provision to the effect that a shareholder of a company may maintain an action in a representative capacity for himself and all other shareholders of the company suing for and on behalf of the company to enforce any rights, duties or obligations owed to the company which could be enforced by the company itself or to obtain damages for any breach thereof. The Act should be further amended to set out the following procedural aspects of the substantive remedy. The shareholder should be required to sue in a representative capacity, it being clear that the judgment or award is to be in favour of and for the benefit of the company. As conditions precedent to the right to bring the action, the plaintiff should be required to establish that he was a shareholder of record at the time the wrong was alleged to have occurred and that he has made reasonable efforts to cause the company to commence or maintain the action on its own behalf. Further, the Act should provide that the intended plaintiff must make application *ex parte* to a judge of the High Court of Ontario designated by the Chief Justice of the High Court for an order permitting the plaintiff to commence the action. In practice, it can be assumed that the application will be supported by affidavit material which would include the draft writ of summons and statement of claim. The shareholder should be required to establish to the court that he is acting *bona fide* and that it is *prima facie* in the interests of the company or its shareholders that the action be brought. If, under proper circumstances, the court makes an order permitting the intended plaintiff

to commence the action, no order shall be made as to security for costs although the judge would be free to make the order on such other terms and conditions as he sees fit. Keeping in mind, however, that the true plaintiff is the company, the nominal plaintiff should be permitted, while the action is pending, to obtain from a judge or the Master an order against the company for the payment of interim costs which would include, among other things, specified solicitor's and counsel fees. The plaintiff, of course, will be accountable to the company in respect of any such interim costs and, as is the case with any other plaintiff in our jurisdiction, runs the risk of the action being dismissed with costs against the plaintiff. In the opinion of the Committee, The Judicature Act would permit the judge at the trial to include in his judgment or order a provision that costs will be payable to the plaintiff as between a solicitor and his own client. However, if there is any doubt as to the correctness of this opinion or if there is concern that judges will not exercise their discretion to award such costs, the Act should specifically provide that the judgment rendered by the court can include an award to the plaintiff for his reasonable costs, including counsel and solicitor's fees and disbursements, incurred in maintaining the action. The Act should contain a provision comparable to that in the New York Business Corporation Law and in the law of many of the United States to the effect that any derivative action so brought shall not be discontinued, compromised or settled without the approval of the court, in the hope that "secret settlements" shall not be made.[89]

89. See also Rule 23(c) of the United States Federal Rules of Civil Procedure.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 5.

Transactions Involving Directors.

7.5.1. Section 70 of the Ontario Act, which corresponds to almost identical provisions in the United Kingdom Companies Act and the Acts of the other Provinces, sets up a procedure whereby a director can obtain immunity from accountability to the company in respect of contracts between himself and the company if he declares his interest in the contract and does not vote in respect thereof at a meeting of directors at which it is considered or, alternatively, if the contract is confirmed by a majority of the votes cast at a general meeting of the shareholders duly called for that purpose. In addition, if either alternative is adopted, the contract is not voidable only by reason of the director's interest in the contract. While the Section does not expressly purport to be concerned with the substantive rights as between the director and the company or its shareholders in respect of any fraudulent or improper transactions, doubts can arise in cases in which the section is invoked as to whether or not the protection of the procedure therein outlined confers immunity from accountability whether or not the transaction constitutes a breach of the director's fiduciary relationship. Further, the Section applies to contracts only and, in the opinion of the Committee, should be extended to apply to any transaction to which the company is or is to be a party. The provision is seriously defective in the further respect that it does not require the director, in declaring his interest in the contract or proposed contract, to describe to the disinterested quorum of his fellow directors the nature and extent of that interest, nor does the statute require the disclosure of the nature and extent of the director's interest in the notice calling any general meeting of shareholders to confirm the contract, although prudence would dictate that the common law rules in this respect would apply.[90]

7.5.2. As a corollary to the recommendations in the preceding Section of this Chapter, the Committee is of the opinion that Section 70 should be broadened and strengthened in several respects: first, the Section should be extended to include all material transactions between a director and the company, secondly, the immunity from accountability of a director who invokes the procedures authorized by the Section should be available only if all details of his interest in the transaction are fully made known to his fellow directors or shareholders and, thirdly,

the immunity from accountability should be available only to an honest director dealing in good faith with the company. Accordingly, the Committee recommends that Section 70 be repealed and that a new provision substantially as follows be substituted therefor:

(1) Every director of a company who has, directly or indirectly, any interest in any contract or transaction to which the company is or is to be a party (other than a contract or transaction limited solely to the remuneration of such director as a director, officer or employee) shall declare his interest in such contract or transaction at a meeting of the directors of the company and shall at that time disclose the nature and extent of such interest including, as to any contract or transaction involving the purchase and sale of assets by or to the company or any subsidiary, the cost of the assets to the purchaser and the cost thereof to the seller if acquired by the seller within 5 years prior to the date of the contract or transaction.

(2) Subsection 1 does not require the disclosure of any interest in any contract or transaction unless the interest and the contract or transaction are both material.

(3) In the case of a proposed contract or transaction, the declaration required by this section shall be made at the meeting of the directors at which the question of entering into the contract or transaction is first considered or, if the director is not at the date of such meeting interested in the proposed contract or transaction, at the next meeting of the directors held after he becomes so interested and, in a case where the director becomes interested in a contract or transaction after it is entered into, the declaration shall be made at the first meeting of the directors held after he becomes so interested.

(4) If a director has made a declaration and disclosure of his interest in a contract or transaction in compliance with this section and has not voted in respect of the contract or transaction at the meeting of the directors of the company, the director, if he is acting in good faith, is not by reason only of his holding the office of director accountable to the company or to its shareholders for any profit or gain realized from the contract or transaction and the contract or transaction, if it is in the best interests of the company, is not voidable by reason only of the director's interest therein.

(5) Notwithstanding anything in this section, a director, if he is acting in good faith, is not accountable to the company or to its shareholders for any profit or gain realized from any such contract or transaction by reason only of his holding the office of director and the contract or transaction, if it is in the best interests

of the company, is not by reason only of the director's interest therein voidable if the contract or transaction is confirmed or approved by a majority of the votes cast at a general meeting of the shareholders duly called for that purpose if the nature and extent of the director's interest in the contract or transaction is declared and disclosed in reasonable detail in the notice calling the meeting or in the information circular required by section 75c.

7.5.3. The amended Section 70 will not disenfranchise the interested director; he will be free to vote as a shareholder at the general meeting at which the contract or transaction is to be considered. This result is consistent with the basic purpose of the proposed Section, namely, that to be relieved from the strict requirement of accountability owed as a fiduciary, the director must fully disclose the nature and extent of his interest in any material contract or transaction to be entered into with the company. The Section, however, is not intended to offer to the dishonest director a means whereby an otherwise improper transaction can be put beyond inquiry or attack by the shareholders.

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90. *Canada Safeway Ltd. v. Thompson et al.* [1951] 3 D.L.R. 295 at 321; *Earle v. Burland* (1900) 27 O.A.R. 540 at 561 (C.A.), varied on other grounds [1902] A.C. 83.

CHAPTER VII

Duties and Responsibilities of Directors

SECTION 6.

Indemnification of Directors.

7.6.1. Section 72 of the Ontario Act provides that a director of a company may "with the consent of the company given at any meeting of the shareholders" from time to time and at all times be indemnified and saved harmless out of the funds of the company from and against all costs, charges and expenses whatsoever that he sustains or incurs in or about any action, suit or proceeding brought against him in respect of any act done by him in or about the execution of the duties of his office or which he sustains in relation to the affairs of the company except, in the latter case, such costs or expenses as are occasioned by his own wilful neglect or default. By-laws providing for such indemnification of directors and officers (although the Section does not mention officers) are almost invariably passed during the organization of the company when the shareholders are usually the nominee first directors of the company. In view of the recommendations made in the earlier Sections of this Chapter, it is obvious that amendments to Section 72 will be required.

7.6.2. The Committee therefore recommends that the Act be amended to provide that a director shall not be indemnified in respect of costs, charges and expenses incurred in any action or proceeding as a result of which he is adjudged to be in breach of any duty or responsibility imposed under the provisions of the Act or by any other rule of law or equity. For greater certainty, on the other hand, we feel that the Act should provide that in a case where a director has achieved complete or substantial success in an action brought against him in his capacity as director, he should be entitled to indemnification by the company.

CHAPTER VIII

Rights of Shareholders

SECTION 1.

Enforcement of Individual Shareholder's Rights.

8.1.1. Earlier in this Report reference has been made to individual shareholder's rights and some examples of such rights were enumerated.[91] This class of rights is to be distinguished from what Palmer[92] would call corporate shareholder rights, that is, rights which the shareholder has agreed to submit to the lawfully expressed will of the majority. In respect of those rights the rule of majority, to which we have earlier referred, applies.[93] The individual shareholder faces no unusual impediment in cases where he wishes to enforce his individual shareholder's rights; here there are no substantive or procedural rules comparable to the Rule in *Foss v. Harbottle* where "corporate shareholder rights" are involved. The individual shareholder has access to the courts to seek equitable or other relief for the enforcement of personal rights owed to the plaintiff as a shareholder. He may maintain an action to enforce any of the various individual rights conferred upon him by statute or common law. Thus, for example, if a shareholder is prevented from exercising the vote attached to the shares owned by him, an individual shareholder's right is infringed and the shareholder may sue for the enforcement of that right.[94] The individual shareholder's rights are, of course, frequently identical with the rights of all other shareholders of the same class. This entitles the plaintiff to proceed in a representative capacity if he elects to do so. This is the usual and desirable practice for it ensures that any judgment is binding on all whom the plaintiff represents, thus precluding the possibility of a multiplicity of actions.

8.1.2. There is in connection with the enforcement of the rights of the individual shareholder a particular area of obscurity which, in the Committee's opinion, should be clarified. The United Kingdom Companies Act and the Companies Acts of the various Provinces of Canada which have adopted the registration system of incorporation provide that the memorandum and articles of association, that is, the constating documents which correspond to the letters patent of incorporation and by-laws, bind the company and its shareholders to the same extent as if they respectively had been signed and sealed by each shareholder and the company and contained covenants on the part of each to observe all the provisions of the memorandum and articles. Many reported decisions based on this statutory provision have held that each individual shareholder may insist upon compliance with the provisions in the memorandum and articles and may sue to enforce such compliance. The legal

question in each case is one concerning the company's constitution not its management.

8.1.3. There is no corresponding provision in the Ontario Act and it is not clear whether or not a shareholder of an Ontario company may sue to enforce compliance by the company with its letters patent, supplementary letters patent or by-laws. The substrata of an Ontario company is not a contract among the incorporators or shareholders but the grant of a charter from the Crown pursuant to a general corporation statute. In view of the Committee's recommendations in Chapter I Section 1 as to the method of incorporation to be adopted for Ontario companies, it would therefore seem desirable that the Ontario Act should specifically provide that individual shareholders may sue for the enforcement of individual rights including compliance with the provisions of the company's charter and by-laws. Accordingly, the Committee recommends an appropriate amendment by way of a new subsection to Section 341 of the Act to effect the recommended change.

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91. Chapter VI, Section 1.

92. Palmer, supra at p. 496.

93. Chapter VII, Section 3.

94. *Pender v. Lushington* (1877) 6 Ch. D. 70 (C.A.) where the court stated at p. 81: that the shareholder is entitled to have his vote recorded and that such was " . . . an individual right in respect of which he has a right to sue. That has nothing to do with the question like that raised in Foss v. Harbottle and that line of cases".

CHAPTER VIII

Rights of Shareholders

SECTION 2.

The Right to Cumulative Voting.

8.2.1. In view of the fact that management of an Ontario company is firmly in the hands of its board of directors, probably the most important individual shareholder's right accruing to the shareholder of an Ontario company is his right to elect the board of directors. Section 64 of the Ontario Act states that where the charter or by-laws of a company so provides, every shareholder entitled to vote at an election of directors has the right to cast a number of votes equal to the number of votes attached to the shares held by him multiplied by the number of directors to be elected and that he may cast all such votes in favour of one candidate or distribute them among the candidates in such manner as he sees fit. This system of voting is known as "cumulative voting", a right which is not given shareholders in the United Kingdom Companies Act or by common law although it has gained widespread acceptance, in various forms, in the United States.

8.2.2. The 1952 Select Committee seemed to recognize the merits of the cumulative voting system but recommended deferment of enacting provisions which would make cumulative voting mandatory until an opportunity had been given to canvass the views of other Canadian jurisdictions on this innovation. That Committee accordingly recommended the enactment of Section 64 which put cumulative voting on a permissive rather than on a mandatory basis. The question which this Committee is therefore required to resolve is whether or not, on grounds of public policy, the cumulative voting system should be mandatory. So long as the system is permissive only, experience has shown that it is highly unlikely that provision will be made for cumulative voting either in the charter or by-laws of a company.

8.2.3. Normally, each voting share carries the right of one vote per share. As a result, shareholders who collectively hold in the aggregate more than 50% of the votes can elect all of the directors of the company. For example, in the case of a company with 10,000 common shares outstanding carrying one vote per share, at a meeting of shareholders called to elect, say, 9 directors, those shareholders who hold shares in the aggregate entitling them to 5,100 votes would, by casting such votes, elect 9 directors of their choice. An opposition group of shareholders with shares aggregating 4,900 votes could muster only 4,900 votes for each candidate for election and, of course, could there-

fore elect none. Under the cumulative voting system, by contrast, the shareholders' group with 5,100 shares would be entitled to a total of 45,900 votes, i.e. 5,100 multiplied by 9 (the number of directors) and the shareholders' group with 4,900 shares would be entitled to 44,100 votes, i.e. 4,900 x 9. By distributing its 44,100 votes among only 4 candidates for election as directors, the minority shareholder group could give each of the 4 candidates 11,025 votes. No matter how the majority distributes the votes available to it, it can elect no more than 5 directors since it cannot give its sixth man as many as 11,025 votes.

8.2.4. Cumulative voting is unknown in the United Kingdom and the subject was not even dealt with by the Jenkins Committee. Cumulative voting is not provided for in any of the other Provinces except Manitoba which adopted permissive but not mandatory cumulative voting in the Companies Act passed in 1964. So far as the Committee is able to ascertain, cumulative voting for corporations originated at the Illinois Constitutional Convention in 1870 and the theory supporting the system was developed by analogy to democratic political organizations designed to uphold the position of minority representation in government. This origin of the cumulative voting system is, in itself, a factor which should be closely scrutinized since there are obvious differences in principle between incorporated business organizations and governmental or law making bodies of any kind. It should also be noted that at the time cumulative voting was introduced in Illinois it "was a very wild and ruthless period of development in American industrial history where there were few limitations on what corporate managers did . . . since then we have developed many means of control".[95] Cumulative voting is provided for either in the general corporation statutes or State constitutions of all of the United States except four. In over one-half of the States cumulative voting is mandatory rather than permissive. The trend in the United States, however, appears to be away from mandatory cumulative voting. Of the 11 States that have adopted cumulative voting since 1950, all but one state have chosen to put it on an optional basis. In addition, the Model Business Corporation Act was amended in 1955 to put cumulative voting, in effect, on an optional basis whereas prior to that time the Model Act provided for mandatory cumulative voting.

8.2.5. Impressive arguments can be made for and against mandatory cumulative voting. Of the arguments in favour of the system, the most persuasive is that based on the "democratic necessity" or "fairness" concept, that is, that the cumulative voting system is equitable and consistent with acceptable democratic principles and therefore should be compulsory. However, this argument depends upon the aptness of the analogy drawn between the incorporated business organization and the political body, an analogy which is inherently defective. The most per-

suasive argument against cumulative voting is that it encourages the election of directors representing particular interest groups who, by virtue of their partisan role, encourage disharmony in the management of the affairs of the company. An American author who made a comprehensive study of cumulative voting established that cumulative voting, in the States in which it was available, was rarely used by shareholders.[96] The author attributed this disinterest to the fact that the typical shareholder, at least in publicly-held companies, has long since come to regard himself as an investor rather than a proprietor and is apparently content to leave management in the hands of the professional managers.

8.2.6. In view of the uncertainties which surround the true value of the cumulative voting system, the Committee does not recommend that cumulative voting be made mandatory for Ontario companies. The many recommended legislative changes outlined in this Report will significantly strengthen the position of the minority shareholder in Ontario and until those recommendations have been implemented and put into practice, it is difficult to know whether or not mandatory cumulative voting would be a necessary or desirable feature of Ontario law.

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95. Should Cumulative Voting for Directors be Mandatory? A Debate, (1955) 11 The Business Lawyer 9.

96. Williams, Cumulative Voting for Directors.

CHAPTER VIII

Rights of Shareholders

SECTION 3.

The Right to Remove Directors.

8.3.1. Section 66 of the Ontario Act states that the letters patent, supplementary letters patent or by-laws may provide, in the case of companies which do not make provision for cumulative voting, that the shareholders may by a resolution passed by at least ⅔ of the votes cast at a general meeting, of which notice specifying the intention to pass such resolution has been given, remove any director before the expiration of his term of office. The question to be determined by the Committee is whether or not the Act should give the shareholders the right to remove directors before the expiration of their term of office rather than conferring upon the company, as is the case under Section 66, the right to provide for removal of directors by appropriate charter or by-law provision. If the right should be conferred on the shareholders, the supplementary question arises as to whether or not removal of a director should be effected by a majority of the votes cast at the meeting or by some number greater than a majority as is presently the case in Section 66.

8.3.2. Prior to the introduction of Section 66 in 1954, removal of directors before the expiration of their term of office was not thought possible as a matter of law. While the legal question was not free from doubt, the most widely held view is that expressed in a leading Canadian text to the effect that removal of directors before the expiration of their term of office should be authorized by appropriate enabling provisions in the charter of the company.[97] This view prevailed principally as a result of an English case[98] which held that directors could not be removed from office before the expiry of their term unless appropriate provision was contained in the articles, this conclusion being supported by the "contract theory" which is the legal foundation for a company incorporated under United Kingdom law.[99] An Ontario court reached a similar conclusion without referring to the English cases or, indeed, without giving any other substantial reason for the result.[100] Whether or not the English cases are rightly decided, the Ontario decision seems to the Committee to be at variance with the common law rule recognized as early as 1728 that shareholders, by majority vote, have an inherent right to remove a director for misconduct in office, which inherent right was recognized by Lord Mansfield in 1758.[101]

8.3.3. Whatever the historical background may be, under the existing provisions of the Ontario Act directors cannot be removed during their term of office unless appropriate provisions are contained in the company's charter or by-laws. As charter or by-law changes must, under the Ontario Act, be initiated by the directors, there is presently no means by which the shareholders could initiate the necessary corporate steps to amend the company's charter or by-laws. This result is aggravated by Section 300 of the Act which permits the election of directors in rotation and enables directors to be elected for terms up to five years. The Companies Acts of British Columbia and Saskatchewan contain provisions to the effect that, in the absence of any contrary provision in the memorandum or articles, a public company may remove directors by special resolution (being one passed by ¾ of the votes cast at the meeting) provided that not less than ¾ of the issued shares of the company are represented at the meeting in person or by proxy. The Manitoba Companies Act is similar to the Ontario Act. In all other provinces and under the Canada Corporations Act, there are no provisions for the removal of directors during their term, so that the unclear case law applies.

8.3.4. The Committee has already observed[102] that probably the most important individual right accruing to the shareholder of an Ontario company is his right to elect the board of directors. There seems to be no logical reason why the corollary right should not exist; that is, there appears no reason why the Act should not authorize the shareholders to remove directors during their term of office. Nor is there any persuasive reason why removal should require a vote in excess of the majority of the votes cast at the meeting duly called for the purpose. The right to remove directors at the instance of shareholders exists in the United Kingdom Companies Act and in the corporation statutes of an increasing number of the United States. The Committee therefore recommends that Section 66 be amended to provide that the shareholders may, by resolution passed by at least a majority of the votes cast at a general meeting called for the purpose, remove any director before the expiration of his term of office but, if the directors have been elected by cumulative voting, no director shall be removed where the votes cast against the resolution for his removal would, if cumulatively voted at an election of the full board of directors, be sufficient to elect one or more directors. If the directors or officers of the company refuse to call a general meeting of shareholders for the purpose of removing a director or directors when asked to do so, the shareholders may then have recourse to the procedure in Section 308 of the Act which permits shareholders to requisition a general meeting of shareholders. Reference is made to Section 4 of this Chapter in which the Committee recommends

significant amendments to Section 308 intended to permit requisitioned meetings to be called at the instance of shareholders much more readily.

97. Fraser & Stewart, supra at 576.

98. *Imperial Hydropathic Hotel Company, Blackpool v. Hampson,* (1882) 20 Ch. D. 1.

99. See Chapter VIII, paragraph 8.1.2.

100. *London Finance Corp. Ltd. v. Banking Service Corp.* [1925] 1 D.L.R. 319.

101. *Lord Bruce's Case,* (1728) 2 Strange 819; *Rex v. Richardson* (1758) 1 Burr. 515.

102. Chapter VIII, paragraph 8.2.1.

CHAPTER VIII

Rights of Shareholders

SECTION 4.

The Right to Requisition Meetings of Shareholders.

8.4.1. Section 308 of the Act provides that shareholders of a company holding not less than 1/10th of the issued voting shares of the company may request the directors to call a general meeting of the shareholders " . . . for any purpose connected with the affairs of the corporation that is not inconsistent with this Act". It would seem that this statutory right is seldom resorted to. The Committee has concluded that the procedural right conferred by the Section has two fundamental deficiencies, only one of which can be satisfactorily remedied. The first is that the requisitioned meeting can be called only at the instance of shareholders holding not less than 1/10th of the issued voting shares, a restriction which prevents the exercise of the right to requisition in many instances. The second deficiency is that the shareholders at a general meeting have the legal authority to initiate only a very limited range of corporate acts. At an annual meeting the shareholders have the right to elect directors and appoint auditors; at a general meeting the shareholders have the right to authorize the surrender of the charter of the company under Section 327, to pass a resolution requiring the company to be wound up voluntarily under Section 243, to pass a resolution to remove the auditor before the expiration of his term of office and, at an annual or general meeting, to pass a resolution under Section 321 appointing an inspector to investigate the affairs and management of the company. If the recommendation in Section 3 of this Chapter is implemented, the shareholders will have the further right to pass a resolution at a general meeting to remove directors during their term of office.

8.4.2. The Committee has stated earlier in this Report, in several contexts, that under the Ontario Act the management of the company is vested in the board of directors. The residual management authority is with the directors and not with the shareholders. As a consequence, the shareholders' right conferred by Section 308 is to a certain extent illusory since only a limited range of corporate acts can be initiated at a meeting of shareholders however called, by requisition or otherwise. The "purpose(s) connected with the affairs of the corporation" in respect of which a requisitioned meeting can be held are, accordingly, confined to a relatively few corporate acts, although admittedly of a fundamental character.

8.4.3. The condition precedent to invoking Section 308, namely, that only shareholders holding not less than 1/10th of the issued voting

shares of the company may do so, is obviously arbitrary and artificial. In order that the relatively limited effect of the Section may be made available more readily, the Committee recommends that the statute be amended to provide that the Section may be invoked either by shareholders holding not less than 1/20th of the issued voting shares of the company or by any shareholder on application to a judge of the High Court designated by the Chief Justice of the High Court, on notice to the company, who may make an order requiring the company to call a general meeting of shareholders "for any purpose connected with the affairs of the corporation that is not inconsistent with" the Act, on such terms as to security for costs or otherwise as the court thinks fit. The applicant should be required to satisfy the court that the application is *bona fide* and that it is *prima facie* in the interests of the company or its shareholders that the meeting be requisitioned.

CHAPTER VIII

Rights of Shareholders

SECTION 5.

The Right to Investigate the Affairs of the Company.

8.5.1. In Section 3 of Chapter VII of this Report, Section 210 of the United Kingdom Companies Act was quoted in part. Section 210 permits any shareholder of a company who complains that the affairs of the company are being conducted "in a manner oppressive to some part of the members (including himself)" to apply to the court for an order " . . . whether for regulating the conduct for the company's affairs in the future, or for the purchase of the shares of any member of the company . . . or otherwise" as the court thinks fit. Referring in the context of Chapter VII to the right of shareholders to redress wrongs done to the company, the Committee dissented from the philosophical basis of Section 210. That Section, phrased as it is in broad terms, also is essentially relevant, however, to the individual shareholder rights with which this Chapter is concerned.

8.5.2. British Columbia is the only Canadian jurisdiction to adopt Section 210 of the United Kingdom Companies Act. The concept, however, has many proponents who regard it as an omnibus solution to the many difficulties (real or imaginary) which can confront the individual shareholder. As the Committee stated in Chapter VII however, Section 210 has an aura of reservation and defeatism about it in that it abandons the solution of the problems of shareholders' rights to the unfettered discretion of the judiciary. There are, in any event, some serious deficiencies inherent in Section 210 as the Jenkins Report recognized.[108] The Committee is of the opinion that the fundamental objection to this approach to the solution of shareholder grievances is its complete abandonment of the functional principle of judicial non-interference in the management of companies.

8.5.3. A right which is approximate but by no means comparable to Section 210 is found in Section 321 of the Ontario Act which provides that shareholders of a company holding shares (whether or not voting shares) representing not less than 1/10th of the issued capital of the company may apply to the court for the appointment of an inspector to "investigate the affairs and management of the corporation" or to "appoint a person to audit its books". A comparable provision exists in the general corporation statutes of all Provinces of Canada except Prince Edward Island. There is very little evidence to establish the extent to which Section 321 or its counterpart in other Provinces has been invoked. The publicity attendant upon the appointment of an inspector could no

doubt have serious adverse ramifications to a commercial enterprise. However, adequate protection to companies is contained in the section in that the applicants are required, in effect, to make out a *prima facie* case to the court. The court can also require the applicants to give security for costs and may prescribe the manner and the extent to which the investigation or audit is to be conducted. The Committee is of the opinion that the underlying principle of Section 321 is equitable and in the interests of shareholders. It should be noted, however, that Section 321 only authorizes an investigation and is not a remedy to right wrongs done to the company or to shareholders. Because the provision is investigatory in nature, one court has said[104]:

> "The section provides an extraordinary remedy applicable only in certain circumstances. It is not intended . . . to provide for a summary investigation into alleged wrongdoing by officers or shareholders of a company in relation to the company's affairs when the information relating to the alleged wrongdoing has been disclosed by the company to its shareholders . . . Where disclosure has been made these are not matters to be enquired into under [the investigation section]"

8.5.4. As is the case with the procedure contemplated by Section 308 of the Act referred to above, the arbitrary condition precedent that the application under Section 321 must be brought by shareholders holding not less than 1/10th of the issued capital does not recommend itself to the Committee. Since the inspector is appointed or the audit is ordered, as the case may be, only by order of the court, the Committee recommends that the Section be amended to provide that the application may be brought by any shareholder or by the Provincial Secretary, thus substantially broadening the availability of the remedy as a statutory means of investigating alleged corporate wrongs. It is further recommended, consistent with other Sections of this Report, that the application shall be to a judge of the High Court designated by the Chief Justice of the High Court. In order to offset the effect of unprogressive jurisprudence, as illustrated by the passage quoted in paragraph 8.5.3, Section 321 should be further amended to ensure that an order may be made under the Section whether or not there has been, in the language of the cases, "disclosure of the matters to be enquired into".

8.5.5. The 1952 Select Committee recommended the adoption of what is now Section 341 of the Ontario Act which reads as follows:

> "Where a shareholder or member or creditor of a corporation is aggrieved by the failure of the corporation or a director, officer or employee of the corporation to perform any duty imposed upon it

or him by this Act, the shareholder, member or creditor, notwithstanding the imposition of any penalty and in addition to any other rights that he may have, may apply to the court for an order directing the corporation, director, officer or employee, as the case may be, to perform such duty, and upon such application the court may make such order or such other order as the court thinks fit."

In essence, this provision merely enables a shareholder or a creditor to apply to the court for an order directing the company or any of its directors, officers or employees, as the case may be, to perform any statutory duty imposed upon it or him by the Act. In view of its limited scope it is not a counterpart of Section 210. It is in fact arguable that the provision is only declaratory of the common law. However that may be, the Committee would not recommend its repeal as there could be circumstances wherein Section 341 might enable a shareholder to make an appropriate application to the court without being required to wait until a statutory duty had been breached and a cause of action thereby possibly accruing to the shareholder, either as an individual or a collective shareholder's right.

8.5.6. Sections 164 and 165 of the United Kingdom Act authorize the Board of Trade to appoint inspectors to investigate the affairs of the company and to report thereon in such manner as the Board directs. This is in keeping with the philosophy of the English Act which gives to the Board of Trade, a department of the government, substantial jurisdiction over the affairs of United Kingdom companies. For the reasons referred to when commenting on Section 210, the Committee does not recommend that the Provincial Secretary in Ontario be given investigatory powers comparable to those given to the Board of Trade in Sections 164 and 165. It is confidently anticipated that the several recommendations in this Report concerning the role of the director and the means whereby shareholders' rights may be enforced will render unnecessary and inappropriate statutory concepts such as are embodied in Sections 164, 165 and 210 of the United Kingdom Act. By the recommendation in paragraph 8.5.4 above the Provincial Secretary will be authorized on his own volition to apply to the court for an order appointing an inspector or ordering an audit. This should prove to be a useful means of guarding the public interest in special cases. Section 4 of The Corporations Information Act presently authorizes the Provincial Secretary to require a corporation at any time to make a return "upon any subject connected with its affairs". It would seem probable that instead of asking for a return under Section 4 the Provincial Secretary will have recourse to the broader investigatory scope of the amended Section 321. Section 4, however, could continue to be a useful means of investigating the affairs of a company in certain cases. The informa-

tion return under Section 4 can be demanded by the Provincial Secretary without the notoriety which surrounds an order made by the court under Section 321. The Committee recommends, however, that the penalty provision in Section 4 be made substantially more stringent so as to ensure compliance by companies with orders made by the Provincial Secretary thereunder.

8.5.7. The recent case of *Re H. Flagal (Holdings) Ltd.*[105] indicated that the Ontario courts feel that Section 321 does not authorize the appointment of an inspector to investigate the affairs of a wholly-owned subsidiary, on the application, under the Section, of a shareholder of the parent company. The Committee accordingly recommends that Section 321 be amended so as to permit the appointment of an inspector to investigate the affairs of a company or any affiliate of the company (as such term is presently defined in Section 90 of the Act). The Committee also recommends that the Section be amended to ensure that the inspector has the right to examine on oath and to require the production of documents from the bankers and auditors of the company in question.

8.5.8. In the Committee's opinion, the provisions of Section 326 (added to the Act in 1962-63) authorizing the Provincial Secretary to conduct an enquiry for the purpose of determining whether or not there is sufficient cause for the Lieutenant Governor to order the cancellation of the letters patent or supplementary letters patent issued to a company or declaring it to be dissolved or terminated is inconsistent with the concept and scope of Section 321(1) of the Act and the recommended amendments thereto referred to in paragraphs 8.5.4 and 8.5.7 of this Section. It is appreciated that the 1962-63 amendments were added for a particular purpose. However, the Committee feels that the recommendations in this Section are more than an adequate substitute for the rights conferred upon the Provincial Secretary under Section 326 and therefore recommends that that Section be amended so that the 1962-63 amendments should not be applicable to corporations with share capital.

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103. Para. 200 et seq.

104. Re *The Companies Act,* Re *Automatic Phone Recorder Company Limited* (1955) 15 W.W.R. 666.

105. (1965) 52 D.L.R. (2d) 385.

CHAPTER IX

The Necessity of Meetings

SECTION 1.

Meetings of Directors.

9.1.1. Section 296 of the Act to which the Committee has made reference on several earlier occasions in this Report provides that the affairs of every corporation shall be managed by a board of directors. The Section expressly states that no business of a corporation shall be transacted by its directors except at a meeting of directors at which a quorum of the board is present. The Section provides that the board of directors shall consist of a fixed number not fewer than three and Section 301 of the Act stipulates that unless the charter or a special resolution otherwise provides, a majority of the directors constitutes a quorum, but in no case can a quorum be less than 2/5 of the number of directors.

9.1.2. At common law it was clear that directors could act and exercise their authority only at regularly constituted meetings[106]; nor, at common law, could a director delegate his duties or assign his powers. The logical foundation for the common law rule is well expressed in an oft-quoted American decision:[107]

> "The personal presence of each director at a meeting of directors as a board is obligatory. Discretionary powers, questions of policy, business administration, all imply the personal attendance at the meeting so that each director may have the benefit of not only the vote, but the voice of every other director, or at least of enough other directors to constitute a quorum . . . A director cannot vote by proxy, because his personal judgment is necessary, and he cannot delegate his duties or assign his powers."

9.1.3. Only in 1964 was the American Model Business Corporation Act amended by the insertion of Section 39A which permits directors to act by consent in writing without the necessity of holding a meeting. The consent in writing is required to be signed by all of the directors *before* the particular action is taken. Some 27 of the United States and the District of Columbia make provision by statute for directors acting by writing without meeting, although the statutory provisions vary widely.

9.1.4. Section 311(1) of the Ontario Act provides that any by-law or resolution signed during a corporation's first year of existence by all the directors is as valid and effective as if passed at a meeting of the directors duly called, constituted and held for that purpose. This pro-

vision was introduced into the Act as the result of a recommendation of the 1952 Select Committee to provide a "means of simplifying the procedure for organization of a corporation by eliminating useless fictions". The recommendation, therefore, did no more than recognize the prevailing practices by which solicitors organized companies following their incorporation. The right of a director to act by a signed by-law or resolution does not, however, extend beyond a company's first year of existence.

9.1.5. Under the United Kingdom Companies Act resolutions in writing signed by all the directors for the time being entitled to receive notice of a meeting of the directors are as valid and effectual as if they had been passed at a meeting of all the directors duly convened and held. The same provision exists in the Companies Act of Nova Scotia.

9.1.6. The Committee recommends that Section 311 be amended to provide, in effect, that a resolution or by-law in writing, at any time signed by all the directors for the time being entitled to receive notice of a meeting of the directors, shall be as valid and effective as if the resolution or by-law had been passed or enacted at a duly convened meeting at which all the directors were present. It is to be noted that the resolution or by-law must be signed by all the directors and not by a mere quorum of them. This recommendation will incorporate into the Act a further extension of the principle introduced in 1954 by Section 311, that is, the elimination of the legal fiction that directors must in all cases meet together for the purpose of exchanging views before any action is taken by them. In the Committee's view, the affairs of a company can be managed satisfactorily without the directors being required in each instance to meet personally for decision making. To prohibit directors from acting except in meetings is to invite non-compliance with the Act. On the other hand, the Committee desires to record its view that directors of publicly-held companies should normally, if not invariably, carry out their legal duties and obligations by means of action taken at duly constituted meetings. The collective consideration and interchange of ideas among directors of publicly-held companies is conducive to good management.

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106. Fraser and Stewart, supra, at 613.

107. *Lippman v. Kehoe Stenograph Co.* (1915) 95 Atl. 895 at 899.

CHAPTER IX

The Necessity of Meetings

SECTION 2.

Meetings of Shareholders.

9.2.1. Earlier Chapters of this Report have noted the relatively restricted role of the shareholders in the management of the affairs of the company having regard to the broad powers conferred upon the directors. The shareholders in general meeting are, however, vested with authority to initiate a relatively limited range of important corporate acts.[108] In addition, under the Ontario Act the shareholders are authorized and empowered to confirm certain acts initiated by the directors either by way of by-law or resolution which acts, on confirmation by the shareholders, express the "will of the company", to use the English expression. Thus, shareholders are required to confirm "with or without variation" resolutions of the directors which, on confirmation, become special resolutions. The company acts by special resolution in respect of an important range of corporate activity, including applications for supplementary letters patent for the various purposes specified in Section 33, increasing or decreasing the number of directors of the company, fixing the quorum at meetings of directors and providing for the election of a chairman of the board. In addition, the Act authorizes the directors to pass by-laws to regulate such significant matters as the allotment of shares, the declaration of dividends, the qualification and remuneration of the directors, the election of directors, the appointment, remuneration and duties and removal of officers, agents and employees, procedures for holding meetings of shareholders and directors and, generally, in respect of "the conduct in all other particulars of the affairs of the company". Any such by-law so passed by the directors is effective only until the next annual meeting of the shareholders, unless in the meantime confirmed at a general meeting of the shareholders duly called for that purpose. The shareholders may at any such annual or general meeting confirm, reject, amend or otherwise deal with any such by-law passed by the directors. The shareholders entitled to vote at meetings of shareholders are accordingly vested with a very broad range of confirmatory powers.

9.2.2. In the case of special resolutions the Act specifically provides that, in lieu of confirmation thereof by at least 2/3 of the votes cast at a general meeting of the shareholders duly called for that purpose, the directors' resolution may be confirmed "by the consent in writing of all the shareholders . . . entitled to vote at such meeting". Further, the Act states that any by-law passed at any time during a corporation's exist-

ence may, in lieu of confirmation at a general meeting, be confirmed in writing by all the shareholders entitled to vote at the meeting. Shareholders of the company, it is therefore clear, are authorized to act in two ways: first, by initiating particular corporate acts by virtue of express statutory authority, such as the election of directors, the appointment of the auditor or the appointment of an inspector; secondly, shareholders are empowered by the Act to confirm, with or without variation or amendment, by-laws and certain resolutions which must first be passed or enacted by the directors and submitted to the shareholders for confirmation. In the latter, but not the former, case the shareholders can at any time act by confirmation in writing in lieu of by vote at a meeting of shareholders.

9.2.3. Section 311(2) of the Act provides that any resolution signed during the corporation's first year of existence by all the shareholders is as valid and effective as if passed at a meeting of the shareholders duly called, constituted and held for that purpose. There seems no justification for limiting such right to the first year of the company's existence. Shareholders are not in a fiduciary relationship either to the company or as among themselves and, unlike directors, can exercise their voting power as individuals and in their own particular interests. Therefore, there is little justification in principle for requiring shareholders to exercise their franchise at meetings if there is unanimity among them. As the Jenkins Report stated, however:

> "Where there is any possibility of there being a difference of opinion between [shareholders] . . . we think there should be a meeting at which it may be discussed".[109]

The Committee therefore recommends that Section 311(2) be amended to provide that any resolution at any time signed by all the shareholders of the company shall be as valid and effective as if the resolution had been passed at a duly convened meeting of the shareholders at which all the shareholders were present. Where there is no unanimity, the matter should be dealt with at a meeting.

108. Chapter VIII, Section 4.

109. Jenkins Report, para. 460.

CHAPTER X

The Role of the Auditor

SECTION 1.

The Duties of the Auditor.

10.1.1. Under the Ontario Act the auditor of a company is appointed by the shareholders at the annual meeting of shareholders.[110] The remuneration of the auditor is fixed by the shareholders or by the directors if they are authorized to do so by the shareholders. If for any reason no auditor is appointed, the Provincial Secretary may, on the application of a shareholder, appoint an auditor for the year in question and fix the remuneration to be paid him by the company for his services. The Act requires the auditor to make "such examination as will enable him to report to the shareholders as required under" Section 82(2) of the Act. That Section sets out the statutory duty of the auditor; it provides that the auditor shall make a report to the shareholders on the "financial statement" required to be laid before the company at the annual meeting by the directors. The report must state whether in the auditor's opinion the financial statement (other than the comparative statement for the preceding year or period) "presents fairly the financial position of the company and the results of its operations for the period under review in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period". The Act defines a "financial statement", in the case of a public company, to include a comparative financial statement for the particular financial year and the preceding financial year comprising a statement of profit and loss for each period, a statement of surplus for each period, a statement of source and application of funds for each period and a balance sheet as at the end of each period.[111] The auditor's report is required to be read at the annual meeting.[112]

10.1.2. In carrying out his duties the auditor has, by the Act, right of access at all times to all records, documents, books, accounts and vouchers of the company and is entitled to require from the directors and officers of the company such information and explanations as in his opinion are necessary to enable him to report. Further, the auditor is entitled to attend any meeting of shareholders and to receive all notices and communications relating to such meeting that a shareholder is entitled to receive and is entitled to be heard at any such meeting that he attends "on any part of the business of the meeting that concerns him as auditor".[113]

10.1.3. It is essential to an understanding of the role of the auditor to appreciate that the preparation of the "financial statement" required

to be laid before the annual meeting of shareholders is the responsibility of the directors of the company and not of the auditors. Sections 84 to 91 inclusive of the Act, which set out the required standards of financial disclosure by which the financial statements are to be prepared, are instructions to the directors of the company and not to the auditor. The auditor's duty is confined to reporting upon the financial statements prepared in accordance with the statutory guidelines and required to be laid before the annual meeting of shareholders by the directors. The research which the Committee carried out revealed that the financial disclosure provisions of the Ontario Act, as amended in 1966, are without a peer in the Companies Acts of any other jurisdiction which came to the Committee's attention. The credit for this high standard of financial disclosure for Ontario companies must be shared with the Institute of Chartered Accountants of Ontario, whose recommendations were incorporated into the Act when it was passed in 1953.

10.1.4. In the opinion of the Committee, no present need has been demonstrated for amendments of major significance to the financial disclosure provisions of the Ontario Act. On the other hand, the Committee concluded that, in the light of recent notorious events in commercial affairs in Ontario, the role of the auditor needed re-examination in order to ascertain if, in the public interest, amendments to the Act were necessary to clarify or alter such role.

10.1.5. The Act does not require the auditor to report in an affirmative way whether or not the company's financial statements are in agreement with its accounting records or are in accordance with the requirements of the Act. Nor is the auditor required to state affirmatively that he has received all the information and explanations that he has required or that proper accounting records have been kept by the company. The Act, however, requires the auditor to make appropriate statements in his report if any of these four standards are not met. Therefore, while it is probably true, as a matter of law, that in discharging his duties as the shareholders' auditor the auditor cannot fail to render a report, he is bound, in certain circumstances, to "qualify" his report either in respect of the four statutory standards last referred to or in respect of any other matter which prevents him from giving an unqualified report on the financial statements. A qualified report is, of course, a serious matter to the company concerned and may be a warning to the shareholders that something is amiss with respect to the financial affairs of the company. In a particularly grave case, the accounting deficiencies or auditing restrictions may be so material that the auditor has no basis for an opinion as to whether or not the financial statements present fairly the financial position of the company so that, in such a case, he would be required to state in his report, giving reasons, that he is unable to express an opinion.

10.1.6. The above outlines summarily the role of the auditor and his duties and rights as provided in the Ontario Act. His role is one of examination and review. He is not required to state whether the financial statements are "correct" or "incorrect"; nor is he required or encouraged to comment upon the efficiency or inefficiency of management. The auditor is not a guarantor and he is called upon by the statute only to give his opinion on the financial statements based on the diligent application of his professional skills. His statutory duty, however, does require him to report on whether or not the financial statements accord with "generally accepted accounting principles". While these principles are not defined in the Act, the development and betterment of what constitutes generally accepted accounting principles receive continuous attention from committees of the Canadian Institute of Chartered Accountants and, in Ontario, of the Institute of Chartered Accountants of Ontario.

110. Section 80.
111. Section 83(1).
112. Section 83(3).
113. Section 82(4).

CHAPTER X

The Role of the Auditor

SECTION 2.

The Independence of the Auditor.

10.2.1. The Act does not state that an auditor need have any special qualifications. In the Committee's opinion, however, no amendment to the Act is required in this respect since the provisions of The Public Accountancy Act[114] effectively prevent anyone from performing the statutory duties of the auditor without being licenced under that Act.

10.2.2. It is the very essence of the auditing function that the auditor be independent, independent not only with respect to reporting but also with respect to programming his audit techniques and procedures and independent in the selection of areas, activities, relationships and managerial policies to be examined in the course of the audit. The Act presently recognizes the necessity of the independence of the auditor by providing that certain persons may not be appointed auditors of public companies. The provision in question reads[115]:

> " . . . no person shall be appointed as auditor of a company who is a director, officer or employee of that company or an affiliated company or who is a partner, employer or employee of any such director, officer or employee."

This standard is lower than that imposed by many of the auditing firms in Canada. The rules of professional conduct of the Institute of Chartered Accountants of Ontario (the "Ontario Institute") contain two provisions in this respect: the first states that a member of the Ontario Institute acting as an auditor "shall maintain independence"; the second provides (not altogether consistently) that no member or a firm of which he is a partner shall express an opinion on the financial statements of a company "if the member, his partners, or his or their immediate families, have any direct or indirect financial interest (or such other interest as could influence the independence of the member or firm)" in the company *unless* the auditor's report discloses such interest.

10.2.3. The Committee has concluded that neither the existing statutory prohibitions nor the rules of the Ontario Institute are adequate to ensure that the auditor shall "maintain independence" especially since the auditor is not presently prohibited from being a shareholder of the company. It is essential to the role of the auditor and for the protection of the public that the auditor must not only be but appear to be independent of management. Accordingly, the Committee recommends

that Section 81 of the Ontario Act be repealed and that provisions substantially as follows be substituted therefor:

> "(1) No person shall be appointed as auditor of a company who is a director, officer or employee of the company or of an affiliated company or who is a partner, employer, employee or associate of any such director, officer or employee;
>
> (2) No auditor of a company shall make a report under subsection 2 of section 82 if such auditor or any partner, employer or associate of any such auditor beneficially owns, directly or indirectly, any capital securities of the company."

10.2.4. In order to provide for the existing situations where auditors presently have a financial interest in companies of which they are the auditors—a state of affairs not now prohibited by the statute—the new Section 81 should contain a transitional provision which would afford the auditor having such an interest an opportunity to dispose of the interest within two years of the coming into force of the amendment which implements the above recommendation provided, however, that he discloses such interest in his report during the transitional period.

10.2.5. If the Committee's recommendation in Chapter II is adopted so that the statutory concept of the "private company" will disappear, the new recommended guidelines for the auditor's independence will apply to all companies, whether closely-held or publicly-held.

10.2.6. In order to safeguard further the independence of the auditor and to ensure that he is at all times acting in the interests of the shareholders who appoint him, the Committee recommends that the Act be amended to provide that an auditor of a company may not be appointed receiver or receiver and manager or liquidator or trustee in bankruptcy of any company of which he is or has been within the two preceding years the auditor. The Rules of Conduct of the Ontario Institute contain a prohibition substantially to this effect and the Committee is of the view that these desirable prohibitions should be incorporated into the statute.

10.2.7. It is generally agreed that one of the most serious threats to the independence of the auditor is the close relationship which frequently (and naturally) develops between management and the auditor. Although as a matter of statute law the auditor is appointed by the shareholders and reports to them he is, in many cases, a financial adviser to management and management's consultant on the financial affairs of the company. Since it is the directors of the company who propose the appointment of a particular auditor or firm of auditors at the annual meeting, it follows that the close relationship which frequently forms between the auditor and the directors can be further accentuated by the fact that, as a practical matter, whether or not he is re-appointed to his

office is a management decision and not that of the shareholders. "Management" in this context sometimes means the president and/or the chief financial officer of the company. In carrying out his role, the auditor not infrequently can feel under pressure to follow the dictates of such officers.

10.2.8. To avert this threat to the auditor's independence, the Committee recommends that, in the case of a company that has issued equity shares which have been distributed in the course of primary distribution to the public, the Act should provide that there shall be an audit committee of the board of directors. Appropriate amendments to the Act should stipulate that the financial statements of the company, together with the auditor's report thereon, required to be approved by the directors under Section 92 of the Act be first submitted to the audit committee for the review and comments of such committee. The auditor should have the right and may be required to appear and should have an opportunity to be heard by the audit committee; the committee should be composed of not less than three directors, of whom a majority shall not be officers of the company or any affiliate of the company. It is hoped that this recommendation will make available to the auditor a means whereby he may discuss with a committee of the directors not only the financial statements and his report thereon, but relevant matters arising therefrom or from his audit generally.

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114. R.S.O. 1960 c. 317.
115. Section 81.

CHAPTER X

The Role of the Auditor

SECTION 3.

Appointment and Removal of the Auditor.

10.3.1. As has been noted, under the Act the auditor of a company is appointed by the shareholders at the annual meeting. There is no statutory requirement that the notice of the annual meeting shall disclose whom it is proposed be appointed as auditor and it is not, in fact, the practice to make reference in the notice to the name of the proposed auditor. Both the law and the practice in this respect are consistent with the principle that the right to appoint the auditor is vested in the shareholders and not in management.

10.3.2. The Regulations under the 1966 amendments to the Ontario Act specify the contents of the information circular required to be forwarded to shareholders by management when proxies are solicited by management. Item 8 of the information circular reads as follows:

> "If action is to be taken with respect to the appointment of auditors, name such auditors and, if appointed within the preceding five years, the date when they were first appointed."

It therefore follows that if the directors do not propose to recommend the re-appointment of the existing auditor, this fact will, of necessity, be disclosed in the information circular. The 1966 amendments to the Act require a new form of proxy to be sent to shareholders when proxies are solicited by management. The form of proxy must provide means whereby the person whose proxy is solicited is "afforded an opportunity to specify that the shares registered in his name shall be voted by the [proxy] nominee in favour of or against each matter or group of related matters identified therein or in the information circular as intended to be acted upon *other than* . . . the appointment of auditors." As a result, the shareholder who votes by his proxy has no means available to him to vote for or against the auditor referred to in the information circular, who is presumably the recommendation of management.

10.3.3. The Committee has concluded that if management does not propose to recommend the re-appointment by the shareholders of the existing auditor, the incumbent auditor should be given an opportunity to be heard by the shareholders on the question of his non-re-appointment. The Committee therefore recommends that the Act be amended to provide that if an auditor other than the incumbent auditor is named in the information circular as proposed to be appointed at the annual

meeting of shareholders, the company shall at least 15 days before the mailing of the notice of the meeting give to the incumbent auditor notice of management's intention not to recommend his re-appointment as auditor at the forthcoming annual meeting. In order that the incumbent auditor may have an opportunity to be heard by shareholders, whether or not they vote by proxy, the incumbent auditor should have the right to furnish to the company, not less than three days prior to the mailing of the notice of the meeting, representations in writing concerning his non-re-appointment as auditor. The company shall be required to forward such representations to the shareholders with the notice of the meeting.

10.3.4. If the underlying reasons for the failure to re-appoint the existing auditor are non-controversial, the incumbent auditor will no doubt decline to take advantage of the right to make representations to the shareholders and his successor will be appointed as auditor at the annual meeting without controversy, especially if the incumbent auditor's report to the financial statements is unqualified. On the other hand, if the directors of the company are seeking to appoint other auditors for any reason which the incumbent auditor believes should be explained to the shareholders, the proposed amendments will give him the opportunity to have his representations circulated to the shareholders. As the incumbent auditor he has, of course, the right to attend the meeting and to be heard "on any part of the business of the meeting that concerns him" as incumbent auditor.

10.3.5. It is hoped that these recommendations will strengthen the role of the auditor as the appointee of the shareholders in that they will tend to prevent the directors from substituting their discretion for the discretion of the shareholders by putting forward for appointment as auditor some person or firm more amenable to management without the incumbent auditor having an opportunity to be heard by the shareholders who appointed him.

10.3.6. Section 80(4) of the Act provides that the shareholders may, by resolution passed by at least two-thirds of the votes cast at a general meeting of which notice of intention to pass the resolution has been given, remove any auditor before the expiration of his term of office, and shall by a majority of the votes cast at that meeting appoint another auditor in his stead for the remainder of his term. In Section 4 of Chapter VIII of this Report, the Committee recommended that significant amendments be made to Section 308 of the Act pursuant to which shareholders may requisition meetings of shareholders, as a result of which recommendations requisitioned meetings will be more readily called at the instance of shareholders. As is the case with the removal of a director during his term of office[116], there seems no logical reason why the shareholders who can appoint an auditor on a majority of the

votes cast at the meeting are required to pass a resolution for his removal by two-thirds of the votes cast at the meeting. The Committee therefore recommends that Section 80(4) be amended to provide that shareholders may remove any auditor before the expiration of his term of office by a resolution passed by at least a majority of the votes cast at a general meeting called for the purpose.

10.3.7. The Committee recommends that Section 80 be amended to provide that, if a general meeting of the shareholders is to be called for the purpose of removing the auditor, the company shall at least 15 days before the mailing of the notice of the meeting give to the incumbent auditor notice of the intention of calling the meeting and copies of any material proposed to be sent to shareholders in connection with the meeting, including the notice of the meeting. The incumbent auditor should have the right to furnish to the company, not less than three days prior to the mailing of the notice of the meeting, representations in writing concerning his proposed removal and the company shall be required to forward such representations to the shareholders with the notice of the meeting. The incumbent auditor has the right under the Act to attend the general meeting and to be heard thereat.

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116. Chapter VIII, Section 3 of the Report.

CHAPTER X

The Role of the Auditor

SECTION 4.

The Right of Shareholders to Require the Attendance of the Auditor at Shareholders' Meetings.

10.4.1. It has been noted that one of the rights of the auditor of a company is his right to attend any meeting of shareholders and to be heard at any such meeting on any part of the business of the meeting that concerns him as auditor. Conversely, however, the shareholders whose appointee the auditor is has no right to require the auditor to attend a meeting of shareholders and answer questions concerning his report on the financial statements. This is obviously illogical and the Committee therefore recommends that the Act be amended to provide that any shareholder of the company, whether or not he is entitled to vote at meetings of shareholders, may by notice in writing to the company given at least five days before any shareholders' meeting is to be held require the attendance of the auditor at such meeting. The proposed amendment should further provide that the auditor shall be required at any such meeting to answer enquiries directed to him limited, however, to the bases on which he has formed the opinion in the report which he is required to make under Section 82 of the Act.

CHAPTER X

The Role of the Auditor

SECTION 5.

The Role of the Auditor of a Holding Company

10.5.1. In August 1965 the Accounting and Auditing Research Committee of the Canadian Institute of Chartered Accountants published Bulletin No. 22 entitled "Reliance on Other Auditors in Reporting on Consolidated Financial Statements". Such Bulletin sets out authoritative guidelines by which it is suggested that the auditor of the parent company may conclude he is reasonably entitled to rely upon the work and opinion of the auditor of a subsidiary company as sufficient supporting evidence for the acceptability of the accounts of the subsidiary. These guidelines, which need not be reproduced here, are based upon legal opinion obtained by the Accounting and Auditing Research Committee as to the duty of care said to be imposed upon the auditor of a parent company to ascertain that the consolidated financial statements of a company and its subsidiary or subsidiaries present fairly the financial position and results of the operations of a parent company and its consolidated subsidiaries if the auditor of one or more of such subsidiaries is not the auditor of the parent.

10.5.2. In cases where an agency arrangement or agreement exists between the auditor of the parent company and the auditor of a subsidiary, it is clear that the parent company auditor is taking full responsibility so far as consolidated financial statements are concerned, for the work of the other auditor. It is equally clear that such other auditor is also responsible in law, as an agent, to the parent company auditor. The difficulties which exist in this area of reliance by the auditor of a parent company, however, arise where no agency relationship exists between the two auditors and it was to set out guidelines for the accounting profession in this respect that Bulletin No. 22 was issued.

10.5.3. The Committee has concluded that it is neither prudent nor desirable for recommendations to be made concerning the developing case law delineating the liability of the auditor for negligence. Therefore, without endeavouring to codify or enlarge the legal liability of the auditor toward the company or to creditors or others, the Committee is of the opinion that the Act should be amended to make clear the scope of the auditor's duty in making a report under Section 82 on financial statements of a company which has one or more subsidiaries the auditor of which is not that of the parent company. The Committee therefore recommends that Section 82 be amended by adding a subsection to read substantially as follows:

> "Whether or not the assets and liabilities and income and expense of any one or more subsidiaries of the holding company are included in the financial statement of the holding company, the report of the auditor of the holding company required by subsection 2 [of section 82] may refer to the reports of auditors of one or more of such subsidiaries but such reference shall not derogate from the duty of the auditor of the holding company to comply with subsection 2 [of section 82]".

The effect of this recommendation is that the auditor of a parent company will thereby be required to assume responsibility for all aspects of the financial statements of the parent company including those relating to the subsidiaries, whether or not the accounts of the subsidiaries are consolidated.

10.5.4. As the result of this recommendation it is necessary that a conforming amendment be made to Section 82 to ensure that the auditor of the parent company has the necessary rights to carry out the duty of reporting in the cases contemplated by the amendment set out in the preceding paragraph. The Committee therefore recommends that Section 82 be amended by adding a subsection reading substantially as follows:

> "The auditor of a holding company has right of access at all times to all records, documents, books, accounts and vouchers of any one or more subsidiaries of the company and is entitled to require from the directors and officers of any such subsidiary such information and explanation as in his opinion are necessary to enable him to report as required by subsection 2 [of section 82]."

CHAPTER XI

The Role of the Trustee under Trust Indentures

11.1.1. It is the invariable practice of companies issuing bonds, debentures, notes or other obligations for sale to the public to issue such obligations under a formal trust document known variously as a trust deed, a trust indenture, a note indenture or the like. The indenture contains the terms and conditions upon which the obligations are issued and sets out in elaborate detail not only the security, if any, for the obligations but also provisions as to issuance, certification and transfer of the obligations, requirements for sinking fund and for redemption or purchase of the obligations, specific covenants to which the issuer becomes subject with respect to the particular obligations and, in the case of secured issues, provisions as to insurance, possession, use and release of mortgaged property, etc. The indenture also contains extensive provisions as to the administration of the trust and for the protection of the trustee. The trustee is a party to the indenture and, by entering into the indenture, becomes a trustee for all the holders of the obligations pursuant to the terms and conditions of the indenture. Trustees under indentures are almost invariably one of the federally or provincially incorporated trust companies carrying on business in Canada.

11.1.2. While the Committee is conscious of the fact that the practices and abuses concerning trustees under trust indentures as they existed in the United States thirty years ago are not, either in degree or kind, necessarily duplicated in Ontario today, nevertheless it is useful as a background to this topic to set out at some length an extract from the Report of the Securities and Exchange Commission of the United States reporting to Congress in 1936. The report in question was directed by Congress to be made at the time the Securities Exchange Act of 1934 was passed.

> "Under modern trust indentures securing issues of corporate bonds, debentures and notes, important powers are vested in the trustee. The security holders themselves are generally widely scattered and their individual interest in the issue is likely to be small. The trustee, on the other hand, is usually a single [trust company]. By virtue of the broad discretionary powers vested in it under the typical trust indenture it is in a position to take immediate action in a variety of ways to protect or enforce the security underlying the bonds, debentures and notes. But the security holders are rarely given any voice in formulation of policies which the trustee pursues; the trust indenture ordinarily does not require that they be consulted before the trustee acts. Hence the trustee generally need not be delayed or embarrassed by the necessity of consulting the security holders or of reconciling their divergent opinions and policies. Theoretically,

the result should be beneficial to all concerned: to the security holder because of increased efficiency, expedition and economy; to the issuer because a trustee is a convenient legal device for conveying title, and because the presence of the trustee relieves the issuer of possible suits and supervision by many individual security holders.

"But, as a matter of fact, this arrangement has resulted in injury to thousands of investors. They have bought securities and have retained no effective control over the issuer's performance of its obligations in respect of them. Such control has been surrendered to or assumed by the trustee. It has been invested with power to certify securities; to supervise the deposit and the withdrawal of collateral and application of funds; to take action upon default; and, in short, to do everything upon which the protection and enforcement of the security of a bondholder depends.

"Both in law and in practice, this reliance of the security holder upon the trustee for protection of his investment is complete. It is a matter of common knowledge that purchasers of securities seldom examine the terms of the trust indenture, although they are legally bound by its terms. Even if they did examine the indenture, the significance of its elaborate provisions would appear only to specialists. In some instances, indeed, it is so drafted that vital provisions apparently escape the notice of highly trained investment agencies. Reliance for adequacy of the security underlying the bonds, notes or debentures, is placed by the investor upon the reputation of the issuer, the underwriting bankers and the trustee. And for honest, faithful and efficient operation of the provisions of the indenture, reliance is placed upon the trustee as representative of the security holders under the terms of the indenture.

" . . . an examination of the provisions of modern trust indentures and their administration by trustees will show that this reliance is unfounded. It will show that typically the trustees do not exercise the elaborate powers which are the bondholders' only protection; that they have taken virtually all of the powers designed to protect the bondholders, but have rejected any duty to exercise them; and that they have shorn themselves of all responsibilities which normally trusteeship imports. The "so-called trustee" which is left is merely a clerical agency and a formal instrument which can be used by the bondholders when and if enough of them combine as specified in the indenture.

. . .

"It is readily admitted by these trustees that they are a species different from the usual trustee of a testamentary or *inter vivos* estate. They say they have not intended in the indentures the assumption of a full quantum of trusteeship duties.

"Nevertheless one basic, fundamental fact cannot be overlooked; the trustee is the only agency avowedly designed for the protection of security holders during the entire life of the security. Furthermore, under the modern trust indenture it alone is capable of effective action. The individual security holder is impotent when acting alone and can get together with his fellow security holders only at great labor and expense. It is likewise true that the common understanding of the lay investor is that the trustee is his *alter ego* in safeguarding his rights. On these facts the trustee should not be allowed, through indenture provisions never seen by the beneficiary, and which would not be understood if they were seen, to whittle away at the number of his express duties until they are practically non-existent, and to surround itself with exculpatory clauses which leave it harmless, despite inactivity or negligence".[117]

11.1.3. The Securities and Exchange Commission concluded in its Report to Congress that it was necessary in the public interest and for the protection of investors (a) that trustees under indentures be disqualified from acting or serving if they have or acquire conflicts of interest incompatible or inconsistent with their fiduciary obligations, and (b) that they be transformed into active trustees with the obligation to exercise that degree of care and diligence which the law attaches to such a fiduciary position. Accordingly, Congress enacted the Trust Indenture Act of 1939 which is, in form, Title III to the Securities Act of 1933 and closely integrated with that Act. The three primary purposes of the Trust Indenture Act were:

1. To provide full and fair disclosure, not only at the time of original issue of bonds, notes, debentures, and similar securities, but throughout the life of such securities;

2. To provide machinery whereby such continuing disclosure may be made to the security holders, and whereby they may get together for the protection of their own interests; and

3. To assure that the security holders will have the services of a disinterested indenture trustee, and that such trustee will conform to the high standards of conduct now observed by the more conscientious trust institutions.[118]

Each of these three primary purposes are, in the opinion of the Committee, of interest and concern to investors in Ontario. However, in view of the fact that the Legislature has recently enacted The Securities Act, 1966 which fundamentally revises the degree and quality of disclosure in connection with the primary distribution of securities to the public, the Committee is now concerned more directly with the third primary

purpose of the Trust Indenture Act, namely, to ensure that the security holders will enjoy the services of a disinterested indenture trustee and that such trustee will conform to high standards of conduct. Set out in Appendix D to this Report are extracts from the Trust Indenture Act.

11.1.4. The Committee recommends that the Ontario Act be amended by adding thereto a new Part which shall provide that trust indentures to which an Ontario company is a party as issuer or guarantor of obligations or which are expressed to be governed by Ontario law shall be required to contain provisions substantially to the following effect:

(a) that in the exercise of the duties, rights and obligations prescribed or conferred by the terms of the indenture, the trustee shall be required to exercise that degree of care, diligence and skill which a reasonably prudent trustee would exercise in comparable circumstances;

(b) that in the exercise of its duties, rights and obligations the trustee may conclusively rely, as to the truth of the statements and correctness of the opinions expressed therein, in the absence of bad faith on the part of the trustee, upon certificates or opinions conforming to the requirements of the indenture, provided, however, that the indenture shall be required to contain provisions requiring the trustee to examine evidence furnished to it in terms comparable to Section 314(c), (e) and (f) and Section 315(a) of the Trust Indenture Act to determine whether or not such evidence conforms to the requirements of the indenture;

(c) that the trustee shall be required to give to holders of securities issued under the indenture, within 60 days after the occurrence thereof, notice of all events of default under the indenture known to the trustee subject, however, to the same proviso as is contained in Section 315(b) of the Trust Indenture Act;

(d) that the indenture shall not contain any provisions relieving the trustee from liability for breach of the duty of care, diligence and skill imposed upon the trustee as referred to in sub-paragraph (a) above except as is provided in Section 315(d) of the Trust Indenture Act;

(e) that a trustee shall not be appointed an indenture trustee if it has any conflict of interest with its role as a fiduciary and that the trustee shall resign from its office in the event any such conflict of interest shall subsequently arise.

In the opinion of the Committee it is not necessary to define "conflict of interest" as is the case, in effect, in Section 310(b) of the Trust Indenture Act as there is no evidence before the Committee that indenture trustees in Ontario have failed to discharge their fiduciary obli-

gations because of the existence of any of the relationships proscribed by that Section. What is or is not, as a matter of fact, a conflict of interest should be clearly discernible in the great majority of cases.

11.1.5. The recommendations in paragraph 11.1.4 impose upon indenture trustees duties and responsibilities commensurate with their proper role as fiduciary for the security holders. The indenture trustee must be independent and must conform to a high standard of conduct in discharging its prescribed duties. There are, however, other problems arising under indentures securing obligations issued to the public. For example, what role should be played by the indenture trustee and, perhaps, by the security purchasers themselves, in seeing to the enforcement of special covenants in the indenture such as the maintenance of specified security for the benefit of the security holders? These other problems should attract the careful and fair-minded attention of issuers, underwriters and fiscal agents so that, through the give and take of contract negotiations leading to the entering into of the indenture, the best interests of the investing public will be served. If the parties to indentures cannot or do not strengthen and upgrade indenture provisions designed to protect the investor, the Legislature will have no alternative but to do by law what could more flexibly be accomplished by strengthening the indenture provisions in the interests of the security holders.

11.1.6. During the last 25 years or so, the practice has grown up in Ontario and elsewhere in Canada whereby the receiver or receiver and manager appointed by the court, in the event of default under indentures securing obligations, whether on the application of the company or a creditor, is frequently the trustee under the indenture securing the obligations in default. In very many cases the company consents to the appointment of the indenture trustee as receiver or receiver and manager. A receiver duly appointed by the court is an officer and representative of the court.[119] A receiver should be wholly disinterested in the subject matter of the receivership. The practice of appointing the indenture trustee as receiver or receiver and manager is, accordingly, a reprehensible practice which should be discontinued, as the indenture trustee is under a fiduciary obligation with respect to the holders of the obligations issued under the indenture. As stated in Kerr[120]:

> "The two characters of trustee and receiver are rarely compatible, and, in addition to this, the appointment of a trustee to act as receiver is, unless he undertakes to act without remuneration, a violation of the rule of equity that a trustee cannot derive any benefit from the discharge of his duty as trustee. The court will even remove a receiver whose private interests are in conflict with his duties, notwithstanding that his acts may for the most part have been for the

general good of the property, and that a majority in number and value of the incumbrancers on it may desire that he be retained."

In order to ensure that the recommendations in paragraph 11.1.4(e) as to the avoidance by indenture trustees of conflicts of interests are fully effective, the Committee suggests that the new Part of the Act recommended in paragraph 11.1.4 should contain a prohibition against an indenture trustee being appointed as receiver or receiver and manager of the assets of the company which issued or guaranteed the obligations issued under the indenture.

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117. SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part VI, Trustees under Indentures (1936), quoted in Loss, Securities Regulation (2d Ed. 1961) Vol. II at 720 et seq.
118. Loss, supra, at 725.
119. Kerr, On the law and Practice as to Receivers (13th Ed., 1963) at 133.
120. Supra, at 105.
121. See also paragraph 10.2.6 above concerning the appointment of auditors as receivers.

CHAPTER XII

Mortmain and Charitable Uses

SECTION 1.

The Law of Charitable Uses.

12.1.1. The Mortmain and Charitable Uses Act[122] provides that land assured otherwise than by will to or for the benefit of any charitable use must be sold, in the absence of a court determined extension, within two years of the date of its acquisition. Further, certain assurances of land to a charitable use are void altogether. "Charitable use" is defined to include the relief of poverty, education, the advancement of religion and any other purpose beneficial to the community. If land validly assured to a charitable use is not sold within the period prescribed, it vests forthwith in the Public Trustee who must cause it to be sold "with all reasonable speed"[123] and after payment of the costs and expenses of the sale the Public Trustee must pay the balance of the proceeds to the trustees for the charity. It would appear that the two-year period may only be extended by a judge of the Supreme Court of Ontario if a contract of sale has been executed in that period or if it is made to appear that a sale of it is imminent. The time may not be extended so that the charity may benefit by an anticipated enhancement in value of the property beyond the two years.[124] If a judge of the Supreme Court of Ontario is satisfied that land conveyed or devised to a charity is required by it for actual occupation for the purposes of the charity, and not as an investment, he may by order sanction the retention of the land.[125]

12.1.2. The historical background of the present legislation can be briefly summarized. The Statute of Elizabeth, 43 Eliz. 1. c. 4, known as the Statute of Charitable Uses, encouraging the making of charitable gifts of land, was the first of a series of enactments relating to this subject in England. The beginning of the 18th century saw a reversal in public policy with respect to charitable gifts in the enactment in 1736 of the Georgian Statute of Mortmain, 9 Geo. II. c. 36. The preamble to that Act refers to the many improvident dispositions of land made by languishing or dying persons and, with the object of avoiding such dispositions, the statute provided that no lands or personalty to be laid out in the purchase of lands should be given to any charitable use unless by deed made at least 12 months before the death of the donor and to take effect in possession for the charitable use immediately. Commenting on the policy of the 1736 Act a noted American author stated[126]:

> "The purpose of the statute must have been in part at least, to prevent the taking of land out of commerce, and not merely to protect the heir of the settlor, since the statute applied to testamentary dispositions of money to be laid out in the purchase of land, although it did not apply to personal property bequeathed as such for charitable purposes."

12.1.3. In 1888 a consolidation of the 1736 Act and amendments thereto was enacted by the English Parliament and known as the Mortmain and Charitable Uses Act, 1888.[127] The 1888 Act did not alter the absolute prohibition of the 1736 Act against devising lands by will for charitable uses but summarized the requirements of a valid inter vivos assurance for the benefit of a charitable use as follows:

(i) the assurance had to take effect in possession for the charitable use immediately;

(ii) save for certain exceptions, there were to be no reservations in favour of the assuror; and

(iii) the assurance had to be by deed and unless made in good faith for full and valuable consideration, be executed at least 12 months before the death of the assuror.

It is to be noted that the 1888 Act did not place any restraint on the power of charities to hold land for purposes of investment so long as it had been validly conveyed to such charities in the first instance.

12.1.4. The 1888 Act was altered by the introduction in England of the Mortmain and Charitable Uses Act, 1891[128] permitting testamentary dispositions of land to charities provided the requirements of that Act were complied with, namely:

> "Land may be assured by will to or for the benefit of any charitable use, but, except as herein-after provided, such land shall, notwithstanding anything in the will contained to the contrary, be sold within one year from the death of the testator, or such extended period as may be determined by the High Court, or any judge thereof sitting at chambers, or by the Charity Commissioners."

The 1891 Act further provided that if it were shown to the satisfaction of the High Court that such land was required for actual occupation by and for the purposes of the charity, its retention could be sanctioned. If the land was not sold within the year, the Act provided that such land vested forthwith in the official trustee of charity lands and the Charity Commissioners were to attend to its sale forthwith.

12.1.5. The policy of the 1891 Act was commented upon by Lord Halsbury in *In re Hume, Forbes v. Hume* where he stated[129]:

> "In 1891 the Legislature . . . determined . . . to allow persons to devise lands as much as they pleased for charitable purposes, but they would more effectively get rid of the real objection, namely, the inalienability of land given to charity, by providing that while any one may make such a disposition as he pleases, when he has done it, the land shall within twelve months be turned into personalty. By that alteration of the whole course of the law the Legislature have attempted to provide against the difficulty which the idea of the inalienability of land had presented to the mind of the Legislature in former times, and which they had endeavoured to meet."

The 1888 and 1891 Statutes remained in force in England until their repeal by the Charities Act, 1960.

12.1.6. The 1736 Georgian Statute of Mortmain was held to be the law of this province as early as 1846.[130] It was not until 1892 that the absolute prohibition of the 1736 Georgian Act against the devise of lands for charitable purposes was removed by the enactment in this province of The Mortmain and Charitable Uses Act, 1892. The 1892 Ontario Act adopted almost verbatim the provisions of the 1891 English Act permitting testamentary dispositions of lands to charities but still subject to the restrictions that such land be sold within a specified period unless held for actual occupation and use by the charity.

12.1.7. The Georgian mortmain law pertaining to inter vivos assurances was repealed in this province by the Mortmain and Charitable Uses Act, 1902[131] adopting substantially the terms of the English Act of 1888 to the effect that inter vivos assurances to charitable uses would be void unless certain requirements were met. As in the case of the English Act of 1888 there was no requirement that land validly assured be sold within any specified period. It will be seen, therefore, that the position in this province in 1902 was substantially that of the English law of that time and it was then only in the case of a testamentary disposition of land that a sale of it within a specified period of time was required. It would appear that the danger of land becoming inalienable when acquired by a charity, otherwise than by will, was either overlooked or was not a matter of public concern in the year 1902.

12.1.8. The 1892 and 1902 Acts were repealed in 1909 and in their place was enacted The Mortmain and Charitable Uses Act, 1909[132] which, except for amendments made in 1927 and 1953 which are not relevant to this Report, remains the law of this province today. It was in the 1909 Statute that the provisions of the present Section 7 were first introduced requiring the sale of land acquired by inter vivos assurance within two years from its acquisition unless such land was actually occupied for the purposes of the charity.

12.1.9. The Province of Quebec is the only other jurisdiction in Canada with legislation comparable to the Ontario Mortmain and Charitable Uses Act. Mortmain legislation is virtually non-existent in the United States.

12.1.10. Many Ontario educational institutions are exempt from the provisions of The Mortmain and Charitable Uses Act by the inclusion in their incorporating statute of special provisions such as the following[133]:

> "The University shall have, in addition to the power, right and privileges mentioned in Section 27 of The Interpretation Act power to purchase or otherwise acquire, take or receive by deed, gift, bequest or devise, and to hold and enjoy any estate or property whatsoever and to sell, grant, convey, mortgage, lease or otherwise dispose of the same or any part thereof from time to time and as occasion may require and to acquire other estate or properties in addition thereto or in the place thereof, without licence in mortmain and without limitation as to the period of holding."

12.1.11. The repeal of the English Acts in 1960 implemented the recommendations of the Committee on the Law and Practice Relating to Charitable Trusts under the chairmanship of the Rt. Hon. Lord Nathan. The following extract from that Report summarizes, it is submitted, not only the position in England at the time of the Report but the position which prevails in Ontario today:

> " . . . mortmain and charitable uses have a long history behind them and now apply, in a highly illogical manner, only to trusts for certain purposes, many types of trusts having from time to time been exempted from them. They are in any case an anachronism in the conditions of the twentieth century and we recommend their repeal . . ."

12.1.12. It is truly an anachronism that contemporary educational institutions and other investors whose form or function falls into the category of a "charitable use" should be prevented from investing any part of the substantial funds at their disposal in real property in Ontario, for what may best be described as a feudal fear that such property might thereby become inalienable. It is known that the funds of modern universities, for example, are invested by skilled investment committees similar to those of corporate investors or financial institutions. The business community of this province could benefit by the removal of the present restrictions so that the substantial funds of such institutions and other similar investors could be made available for the development of real property. It is equally an anachronism that the law should prohibit or restrict deathbed gifts or devises of land to charitable,

educational or religious objects. Land no longer has the economic significance it had at the time of the enactment of the Georgian mortmain laws.

12.1.13. The Committee recommends that Sections 6 to 13 inclusive of The Mortmain and Charitable Uses Act be repealed and that any land in fact held by any charitable institution at the date of such amendment may continue to be so held by any such institution without restriction as to time and without risk of forfeiture or vesting in any public authority, and that any land so held by any such institution which at the date of such amendment has by virtue of Section 7(2) of the Act vested in the Public Trustee but in respect of which the Public Trustee has not caused any steps to be taken for its sale as required by Section 10(2) of the Act shall be immediately re-vested in such institution.

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122. R.S.O. 1960, c. 246.
123. Section 10(2).
124. In Re *Sidebottom, Beeley v. Sidebottom,* [1901] 2 Ch. 1 at 5, reversed on different grounds [1902] 2 Ch. 389.
125. Sections 7(3) and 12 respectively.
126. Scott, Abridgment of the Law of Trust, p. 656.
127. 51 & 52 Vict. c. 42.
128. 54 & 55 Vict. c. 73.
129. [1895] 1 Ch. 422 at 433.
130. *Doe d. Anderson v. Todd et al* (1846) 2 U.C.Q.B. 82; *Cleary v. Purcell* (1894) 23 S.C.R. 101.
131. S.O. 2 Ed. VII c. 2.
132 S.O. 9 Ed. VII c. 58.
133. See, for example: The Victoria University Act, 1951, S.O. 1951 c. 119.

CHAPTER XII

Mortmain and Charitable Uses

SECTION 2.

The Law of Mortmain.

12.2.1. Although mortmain and charitable uses are dealt with together in The Mortmain and Charitable Uses Act, they are in fact two distinct matters. Since Magna Carta there has been a series of statutes prohibiting or restricting conveyances of land to charitable and other corporations. The purpose of these enactments was on the one hand to prevent the disinheriting of heirs and the loss of dues owed to the feudal lord and, on the other hand, to prevent corporations from becoming too powerful by the accumulation of what was then the main source of wealth—landed property. Thus, corporations whose existence was perpetual were restricted from accumulating real property in mortmain—in the "dead hand".

12.2.2. Section 2(1) of The Mortmain and Charitable Uses Act of Ontario provides that land cannot be assured to or for the benefit of or acquired or held by or on behalf of any corporation in mortmain *otherwise* than under the authority of a licence or a statute. The term "assurance" is defined in the Act as including a gift, conveyance, appointment, lease, transfer, settlement, mortgage, charge, encumbrance, devise, bequest and every other assurance by deed, will or other instrument. The term "land" is defined in the Act as including tenements and hereditaments, corporeal and incorporeal, of whatever tenure, but not money secured on land or other personal estate arising from or connected with land.

12.2.3. The prohibition in Section 2(1) is a general one: no corporation can acquire land unless it does so under authority of a statute or a licence of the Province. The Mortmain and Charitable Uses Act has been held to be *intra vires* the Legislature of Ontario and, therefore, applicable to lands acquired by companies incorporated under the Canada Corporations Act but not, of course, to lands acquired by certain specified corporations over which the Federal Parliament has exclusive legislative authority under the British North America Act.[134] The Act provides for the issuance of licences in mortmain but such licences are not required if the corporation has some other authority to hold land: for example, a corporation which holds a licence as an extra-provincial corporation under Part IX of the Ontario Act thereby has authority to hold land for certain purposes; The Insurance Act (Ontario) provides that an insurer licenced under that Act may acquire

and hold such real property as is necessary for the transaction of its business or bona fide mortgaged to it by way of security; and The Loan and Trust Corporations Act authorizes certain companies subject to that Act to take and hold real property. The authority of companies incorporated under the Ontario Act to hold land is contained in Section 288 and 289 of the Act and the authority conferred by these Sections can be broadened by including in the charter of the company specific powers to acquire and hold real property.

12.2.4. In the opinion of the Committee, the historical bases for the Ontario mortmain legislation have ceased to be meaningful. The vestiges of mortmain legislation which remained in England at the time of the Nathan Report have been repealed.[135] There are, moreover, some potentially serious problems arising from the definition of the term "assurance" in The Mortmain and Charitable Uses Act in that the definition would appear to include any lease, thereby prohibiting leases without the authority of a statute or licence. There being no evidence that mortmain legislation serves any useful purpose or that any element of public interest is being protected thereby, the Committee recommends that Sections 1 to 5 inclusive of The Mortmain and Charitable Uses Act be repealed.

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134. *Great West Saddlery Company Limited v. The King* [1921] 2 A.C. 91 at 119.
135. The Charities Act, 1960, 8 & 9 Eliz. II c. 58.

CHAPTER XIII

Filing of Accounts in Office of Public Record

13.1.1. The Ontario Act requires a public company to forward to each shareholder a copy of the financial statement of the company and a copy of the auditor's report. Shareholders of a private company are entitled under the Act to be furnished by the company, on demand, with a copy of the financial statement and auditor's report.[136] Neither the public nor the private company is required to file its financial statement with the Provincial Secretary or in any office of public record, nor has any such requirement ever existed in Ontario law.[137]

13.1.2. The Canada Corporations Act requires a public company to file its annual financial statements with the Registrar-General and a comparable provision is found in the Companies Acts of British Columbia, Alberta and Saskatchewan. These requirements, however, do not apply to private companies. It should also be noted that the applicable provisions in the laws of British Columbia, Alberta and Saskatchewan require only that a copy of the balance sheet be filed and not copies of the statement of profit and loss, statement of earned surplus or any other statement. When the Canada Corporations Act was introduced in the Parliament of Canada in 1964, the Bill provided, in effect, that the financial statements required to be filed with the Department of the Secretary of State should not be open for public inspection except on the written direction of the Secretary of State given on the recommendation of the Chief Justice or Acting Chief Justice of the court of the province in which the head office of the company is situated. This provision was deleted by amendment in the Standing Committee on Banking and Commerce, so that the Bill as finally passed did not contain the suggested restriction on the availability of the financial statements for public inspection.

13.1.3. The United Kingdom Companies Act requires all companies other than "exempt private companies" to file accounts in an office of public record. It has been pointed out in Chapter II, Section 1 of this Report that the distinction between public and private companies was first introduced in the English Companies Act in 1908 in order to distinguish between those companies which should and those companies which should not file in an office of public record copies of their balance sheets. As a result of recommendations of the Cohen Committee, the United Kingdom Companies Act was amended in 1948 to introduce a sophisticated distinction between exempt and non-exempt private companies, thereby requiring all companies other than exempt private companies to file accounts. However, the concept of the exempt private company was found in practice to be "notoriously complicated" and the

Jenkins Committee recommended the abolition of this distinction between exempt and non-exempt private companies, with the result that all companies would be required to file accounts.[138] A government bill implementing this recommendation has been introduced into the United Kingdom Parliament.

13.1.4. Section 133 of The Securities Act, 1966 will require Ontario companies whose equity shares have been distributed to the public in Ontario in the course of primary distribution to the public to file with the Ontario Securities Commission financial statements, auditor's reports thereon and interim financial statements that are required to be mailed by the company to its shareholders. The financial statements so filed with the Commission shall be open to public inspection. This, of course, is a new requirement of Ontario law which should prove to be of value to investment dealers, security analysts, representatives of the press and the investing public in general.

13.1.5. The question faced by the Committee was whether or not all Ontario companies should be required to file their financial statements in an office of public record. The question should more meaningfully be put in another way, namely, what categories of persons have a genuine and legitimate right to financial information concerning companies with which they deal? The present law requires that the financial information of both public and private companies be made available only to shareholders. The question is a vexing one. Cogent arguments can be made in favour of a full disclosure rationale. Many proponents of unrestricted financial disclosure hold to the belief that full disclosure is the price tag attached to doing business in the corporate form, whether the company is public or private. The question, however, is not that straightforward; complex economic issues are involved. Critics of the suggestion that all companies should file their financial statements in an office of public record talk of invasion of personal privacy, especially with regard to closely-held companies or family investment and holding companies. Such critics say there are no legitimate reasons for the disclosure of financial information in such cases. Suppliers and others dealing with the closely-held company which carries on business with the public would not, the critics contend, avail themselves of the filed information and, in any event, since the filing would perforce be only on an annual basis, the information available would quickly be out of date. Further, the critics say, if financial statements were required to be made public. attempts would be made by management to make them less rather than more meaningful. As many of the companies incorporated in Ontario are, in essence, small incorporated proprietorships or partnerships, the cost of preparing full financial statements for public filing could be said to be an unfair burden. Both the proponents and opponents of the question agree that mandatory filing of financial statements would disclose

information to competitors with a resultant possibility of competitive detriment in many cases. Further, public disclosure would enable take-over bidders and others to scrutinize the financial affairs of companies with a view to acquisition. The sole proprietor or the small partnership would no doubt hesitate to seek the benefits of incorporation if public disclosure of all financial information was the cost of incorporation.

13.1.6. A compromise between the proponents and opponents of public filing of accounts might be possible if an accurate and workable statutory definition could be devised to divide the class of companies which should be required to file their financial statements from those which should not be so required. The Committee has concluded, however, that in the light of the experience in the United Kingdom a satisfactory statutory segregation of the two classes of companies is probably not possible. The myriad types of businesses seem to preclude the possibility of fairly separating those companies which should be required to file their accounts from those companies which should not.

13.1.7. The Committee does not recommend that the financial statements of all companies be required to be filed with the Provincial Secretary or in any office of public record. No change in the existing law is suggested. In reaching this conclusion consideration was given to the meritorious arguments on both sides of this difficult question. The balancing factor in the Committee's conclusion was that there is, at present, no way of assessing the real social value from a public interest standpoint of the harsh requirement that all companies, without exception, disclose their financial affairs to the general public. Future experience from the operation of Section 133 of The Securities Act, 1966 might develop guidelines by which it is possible to assess the economic value to the whole community of complete disclosure of financial affairs of all companies. However, in the absence of such guidelines the Committee is not prepared to recommend that Ontario should pass legislation which would, in effect, cause it to be the first Canadian jurisdiction which requires mandatory disclosure of the financial affairs of all companies incorporated within the jurisdiction. Only four of the United States require the filing of any financial information in an office of public record.[139]

136. Section 93.
137. Section 139 of the Act, however, requires a co-operative corporation to transmit to the Provincial Secretary after each annual meeting a copy of its financial statement and auditor's report.
138. Jenkins Report, paras. 55 to 63.
139. Massachusetts and Michigan require the annual filing in an office of public record of a statement of assets and liabilities. Indiana and Nebraska have lesser requirements.

CHAPTER XIV

The Need for a "Companies' Court"

14.1.1. A number of the recommendations in this Report will, if implemented, result in applications being made by shareholders and others "to a judge of the High Court designated by the Chief Justice of the High Court". The quoted expression, which we have used throughout the Report, is taken from The Securities Act, 1966 which introduced into that Act the concept of the use of "designated" judges for the adjudication of various security law matters arising under that statute. For example, a particular take-over bid may be exempted from the take-over bid requirements of The Securities Act, 1966 by order of a designated judge[140]; the Ontario Securities Commission may apply to a designated judge to require the compliance by any person or company of the insider trading reporting requirements of the Act[141]; and a designated judge may make an order requiring the Ontario Securities Commission, in certain circumstances, to commence or continue an action to enforce in the name and on behalf of the company the unlawful insider trading provisions of the Act.[142]

14.1.2. Similarly, the 1966 amendments to the Ontario Act contain provisions corollary to those referred to above in The Securities Act, 1966. The Ontario Securities Commission may apply to "a judge of the High Court designated by the Chief Justice of the High Court" for an order requiring compliance by any person with the insider trading reporting requirements of the Act[143]; a designated judge may make an order requiring the Ontario Securities Commission to commence or continue an action in the name and on behalf of the company to enforce the unlawful insider trading provisions of the Act[144]; any interested person or company may apply to a designated judge for an order exempting any person or company from the new requirements as to mandatory proxy solicitation, the form of proxy and the furnishing of an information circular[145]; a public company may apply to a designated judge for an order permitting the omission from the company's financial statements of sales or gross operating revenues otherwise required to be disclosed.[146]

14.1.3. Taken together, these provisions in The Securities Act, 1966 and the 1966 amendments to the Ontario Act and, assuming their implementation, the various recommendations in this Report will no doubt result in numbers of applications being made to the court for the various forms of relief made available by the new enactments. In the Committee's opinion, the public interest would be best served if these applications in the security and corporation law field were made to

judges of the High Court designated by the Chief Justice of the High Court, so that the designated judges can accumulate expertise and familiarity in this specialized area. Furthermore, the use of designated judges would enable orders to be obtained with a minimum of delay and inconvenience to the public. The Committee, therefore, recommends that the Chief Justice of the High Court of Ontario be asked to designate not less than five judges of the High Court as judges who should hear the various applications brought under The Securities Act, 1966 and The Corporations Act as it is to be amended. These designated judges would, in effect, constitute a "Companies' Court" to deal with the specialized proceedings which will arise under the new and complex legislation. The Committee also recommends that the Rules of Practice of the Supreme Court of Ontario be amended appropriately to recognize the existence of such a "Companies' Court" as is the case in the United Kingdom where the Rule Committee of the Supreme Court has promulgated rules setting out the procedure to govern applications under the various provisions of the United Kingdom Companies Act.

140. Section 89.
141. Section 112.
142. Section 114.
143. Section 71c(5).
144. Section 71e(1).
145. Section 75d(2).
146. Section 84(3).

Appendix A

Extracts from the New York State Business Corporation Law re incorporation and charter amendment

§ 402. Certificate of incorporation; contents.—(a) A certificate, entitled "Certificate of incorporation of .... (name of corporation) under section 402 of the Business Corporation Law", shall be signed by each incorporator, with his name and address stated beneath or opposite his signature, acknowledged and delivered to the department of state . . .

[*Here follow the specified contents of the certificate*]

§ 403. Certificate of incorporation; effect—Upon the filing of the certificate of incorporation by the department of state, the corporate existence shall begin, and such certificate shall be conclusive evidence that all conditions precedent have been fulfilled and that the corporation has been formed under this chapter, except in an action or special proceeding brought by the attorney-general.

§ 801. Right to amend certificate of incorporation. —(a) A corporation may amend its certificate of incorporation, from time to time, in any and as many respects as may be desired, if such amendment contains only such provisions as might be lawfully contained in an original certificate of incorporation filed at the time of making such amendment.

(b) In particular, and without limitation upon such general power of amendment, a corporation may amend its certificate of incorporation, from time to time, so as: . . .

[*Here follow 13 types of specified amendments*]

. . .

(14) To strike out, change or add any provision, not inconsistent with this chapter or any other statute, relating to the business of the corporation, its affairs, its rights or powers, or the rights or powers of its shareholders, directors or officers, including any provision which under this chapter is required or permitted to be set forth in the by-laws, except that a certificate of amendment may not be filed wherein the duration of the corporation shall be reduced.

§ 805. Certificate of amendment; contents.—(a) To accomplish any amendment, a certificate of amendment, entitled "Certificate of amendment of the certificate of incorporation of .... (name of corporation) under section 805 of the Business Corporation Law," shall be signed, verified and delivered to the department of state. . . .

[*Here follow the specified contents of the certificate of amendment*]

[The law of New York contains special provisions applicable to the incorporation of banks, insurance companies and co-operatives.]

Appendix B

Extracts from the New York State Business Corporation Law re purchase of a company's own shares

§513. Purchase or redemption by a corporation of its own shares.

(a) A corporation, subject to any restrictions contained in its certificate of incorporation, may purchase its own shares, or redeem its redeemable shares, out of surplus except when currently the corporation is insolvent or would thereby be made insolvent.

(b) A corporation may purchase its own shares out of stated capital except when currently the corporation is insolvent or would thereby be made insolvent, if the purchase is made for the purpose of:

(1) Eliminating fractions of shares;

(2) Collecting or compromising indebtedness to the corporation; or

(3) Paying shareholders entitled to receive payment for their shares under section 623 (Procedure to enforce shareholder's right to receive payment for shares).

. . .

§514. Agreements for purchase by a corporation of its own shares.

(a) An agreement for the purchase by a corporation of its own shares shall be enforceable by the shareholder and the corporation to the extent such purchase is permitted at the time of purchase by section 513 (Purchase or redemption by a corporation of its own shares).

(b) The possibility that a corporation may not be able to purchase its shares under section 513 shall not be a ground for denying to either party specific performance of an agreement for the purchase by a corporation of its own shares, if at the time for performance the corporation can purchase all or part of such shares under section 513.

§515 Reacquired shares.

(a) Shares that have been issued and have been purchased, redeemed or otherwise reacquired by a corporation shall be cancelled if they are reacquired out of stated capital, or if they are converted shares, or if the certificate of incorporation requires that such shares be cancelled upon reacquisition.

(b) Any shares reacquired by the corporation and not required to be cancelled may be either retained as treasury shares or cancelled by the board at the time of reacquisition or at any time thereafter.

(c) Neither the retention of reacquired shares as treasury shares, nor their subsequent distribution to shareholders or disposition for a con-

sideration shall change the stated capital. When treasury shares are disposed of for a consideration, the capital surplus shall be increased by the full amount of the consideration received unless the corporation excercises the option granted in subparagraph (a)(5) of section 517 (Special provisions relative to surplus and reserves).

(d) When reacquired shares other than converted shares are cancelled, the stated capital of the corporation is thereby reduced by the amount of stated capital then represented by such shares plus any stated capital not theretofore allocated to any designated class or series which is thereupon allocated to the shares cancelled. The amount by which stated capital has been reduced by cancellation of reacquired shares during a stated period of time shall be disclosed in the next financial statement covering such period that is furnished by the corporation to all its shareholders or, if practicable, in the first notice of dividend or share distribution that is furnished to the holders of each class or series of its shares between the end of the period and the next such financial statement, and in any event to all its shareholders within six months of the date of the reduction of capital.

(e) Shares cancelled under this section are restored to the status of authorized but unissued shares. However, if the certificate of incorporation prohibits the reissue of any shares required or permitted to be cancelled under this section, the board by certificate of amendment under section 805 (Certificate of amendment; contents) shall reduce the number of authorized shares accordingly.

Appendix C

Uniform Commercial Code — Article 8
incorporating officially recommended amendments thereto

Article 8

INVESTMENT SECURITIES

Part 1. Short Title and General Matters

§8-101. Short Title.

This Article shall be known and may be cited as Uniform Commercial Code—Investment Securities.

§8-102. Definitions and Index of Definitions.

(1) In this Article unless the context otherwise requires

(a) A "security" is an instrument which

(i) is issued in bearer or registered form; and

(ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

(b) A writing which is a security is governed by this Article and not by Uniform Commercial Code-Commercial Paper even though it also meets the requirements of that Article. This Article does not apply to money.

(c) A security is in "registered form" when it specifies a person entitled to the security or to the rights it evidences and when its transfer may be registered upon books maintained for that purpose by or on behalf of an issuer or the security so states.

(d) A security is in "bearer form" when it runs to bearer according to its terms and not by reason of any indorsement.

(2) "proper form" means regular on its face with regard to all formal matters.

(3) A "subsequent purchaser" is a person who takes other than by original issue.

(4) A "clearing corporation" is a corporation all of the capital stock of which is held by or for a national securities exchange or association

registered under a statute of the United States such as the Securities Exchange Act of 1934.

(5) A "custodian bank" is any bank or trust company which is supervised and examined by state or federal authority having supervision over banks and which is acting as custodian for a clearing corporation.

(6) Other definitions applying to this Article or to specified Parts thereof and the sections in which they appear are:

"Adverse claim". Section 8-301.

"Bona fide purchaser". Section 8-302.

"Broker". Section 8-303.

"Guarantee of the signature". Section 8-402.

"Intermediary bank". Section 4-105.

"Issuer". Section 8-201.

"Overissue". Section 8-104.

(7) In addition Article 1 [not reproduced in this Appendix] contains general definitions and principles of construction and interpretation applicable throughout this Article.

§8-103. Issuer's Lien.

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is noted conspicuously on the security.

§8-104. Effect of Overissue; "Overissue."

(1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue; but

(a) if an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may compel the issuer to purchase and deliver such a security to him against surrender of the security, if any, which he holds; or

(b) if a security is not so available for purchase, the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

(2) "Overissue" means the issue of securities in excess of the amount which the issuer has corporate power to issue.

§8-105. Securities Negotiable; Presumptions.

(1) Securities governed by this Article are negotiable instruments.

(2) In any action on a security

(a) unless specifically denied in the pleadings, each signature on the security or in a necessary indorsement is admitted;

(b) when the effectiveness of a signature is put in issue the burden of establishing it is on the party claiming under the signature but the signature is presumed to be genuine or authorized;

(c) when signatures are admitted or established production of the instrument entitles a holder to recover on it unless the defendant establishes a defence or a defect going to the validity of the security; and

(d) after it is shown that a defence or defect exists the plaintiff has the burden of establishing that he or some person under whom he claims is a person against whom the defence or defect is ineffective (Section 8-202).

§8-106. Applicability.

The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.

§8-107. Securities Deliverable; Action for Price.

(1) Unless otherwise agreed and subject to any applicable law or regulation respecting short sales, a person obligated to deliver securities may deliver any security of the specified issue in bearer form or registered in the name of the transferee or indorsed to him or in blank.

(2) When the buyer fails to pay the price as it comes due under a contract of sale the seller may recover the price

(a) of securities accepted by the buyer; and

(b) of other securities if efforts at their resale would be unduly burdensome or if there is no readily available market for their resale.

Part 2. Issue—Issuer

§8-201. "Issuer."

(1) With respect to obligations on or defenses to a security "issuer" includes a person who

(a) places or authorizes the placing of his name on a security (otherwise than as authenticating trustee, registrar, transfer agent or the like) to evidence that it represents a share, participation or other interest in his property or in an enterprise or to evidence his duty to perform an obligation evidenced by the security; or

(b) directly or indirectly creates fractional interests in his rights or property which fractional interests are evidenced by securities; or

(c) becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defenses to a security a guarantor is an issuer to the extent of his guaranty whether or not his obligation is noted on the security.

(3) With respect to registration of transfer (Part 4 of this Article) "issuer" means a person on whose behalf transfer books are maintained.

§8-202. Issuer's Responsibility and Defenses; Notice of Defect or Defense.

(1) Even against a purchaser for value and without notice, the terms of a security include those stated on the security and those made part of the security by reference to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order or the like to the extent that the terms so referred to do not conflict with the stated terms. Such a reference does not of itself charge a purchaser for value with notice of a defect going to the validity of the security even though the security expressly states that a person accepting it admits such notice.

(2) (a) A security other than one issued by a government or governmental agency or unit even though issued with a defect going to its validity is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of constitutional provisions in which case the security is valid in the hands of a subsequent purchaser for value and without notice of the defect.

(b) The rule of subparagraph (a) applies to an issuer which is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as otherwise provided in the case of certain unauthorized signatures on issue (Section 8-205), lack of genuineness of a security is a complete defense even against a purchaser for value and without notice.

(4) All other defenses of the issuer including non-delivery and conditional delivery of the security are ineffective against a purchaser for value who has taken without notice of the particular defense.

(5) Nothing in this section shall be construed to affect the right of a party to a "when, as and if issued" or a "when distributed" contract to cancel the contract in the event of a material change in the character of

the security which is the subject of the contract or in the plan or arrangement pursuant to which such security is to be issued or distributed.

§8-203. Staleness as Notice of Defects or Defenses.

(1) After an act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer.

(a) if the act or event is one requiring the payment of money or the delivery of securities or both on presentation or surrender of the security and such funds or securities are available on the date set for payment or exchange and he takes the security more than one year after that date; and

(b) if the act or event is not covered by paragraph (a) and he takes the security more than two years after the date set for surrender or presentation or the date on which such performance became due.

(2) A call which has been revoked is not within subsection (1).

§8-204. Effect of Issuer's Restrictions on Transfer.

Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it.

§8-205. Effect of Unauthorized Signature on Issue.

An unauthorized signature placed on a security prior to or in the course of issue is ineffective except that the signature is effective in favor of a purchaser for value and without notice of the lack of authority if the signing has been done by

(a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security or of similar securities or their immediate preparation for signing; or

(b) an employee of the issuer or any of the foregoing entrusted with responsible handling of the security.

§8-206. Completion or Alteration of Instrument.

(1) Where a security contains the signatures necessary to its issue or transfer but is incomplete in any other respect

(a) any person may complete it by filling in the blanks as authorized; and

(b) even though the blanks are incorrectly filled in, the security as

completed is enforceable by a purchaser who took it for value and without notice of such incorrectness.

(2) A complete security which has been improperly altered even through fraudulently remains enforceable but only according to its original terms.

§8-207. Rights of Issuer With Respect to Registered Owners.

(1) Prior to due presentment for registration of transfer of a security in registered form the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications and otherwise to exercise all the rights and powers of an owner.

(2) Nothing in this Article shall be construed to affect the liability of the registered owner of a security for calls, assessments or the like.

§8-208. Effect of Signature of Authenticating Trustee, Registrar, or Transfer Agent.

(1) A person placing his signature upon a security as authenticating trustee, registrar, transfer agent or the like warrants to a purchaser for value without notice of the particular defect that

(a) the security is genuine and in proper form; and

(b) his own participation in the issue of the security is within his capacity and within the scope of the authorization received by him from the issuer; and

(c) he has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects.

Part 3. Purchase

§8-301. Rights Acquired by Purchaser; Title Acquired by Bona Fide Purchaser.

(1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be unauthorized or wrongful or that a particular adverse person is the owner of or has an interest in the security.

(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.

(3) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

§8-302. "Bona Fide Purchaser."

A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank.

§8-303. "Broker."

"Broker" means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, or buys a security from or sells a security to a customer. Nothing in this Article determines the capacity in which a person acts for purposes of any other statute or rule to which such person is subject.

§8-304. Notice to Purchaser of Adverse Claims.

(1) A purchaser (including a broker for the seller or buyer but excluding an intermediary bank) of a security is charged with notice of adverse claims if

(a) the security whether in bearer or registered form has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(b) the security is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor. The mere writing of a name on a security is not such a statement.

(2) The fact that the purchaser (including a broker for the seller or buyer) has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute notice of adverse claims. If, however, the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or that the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims.

§8-305. Staleness as Notice of Adverse Claims.

An act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange does not of itself constitute any notice of adverse claims except in the case of a purchase

(a) after one year from any date set for such presentment or surrender for redemption or exchange; or

(b) after six months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date.

§8-306. Warranties on Presentment and Transfer.

(1) A person who presents a security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment or exchange. But a purchaser for value without notice of adverse claims who receives a new, reissued or re-registered security on registration of transfer warrants only that he has no knowledge of any unauthorized signature (Section 8-311) in a necessary indorsement.

(2) A person by transferring a security to a purchaser for value warrants only that

(a) his transfer is effective and rightful; and

(b) the security is genuine and has not been materially altered; and

(c) he knows no fact which might impair the validity of the security.

(3) Where a security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against such delivery, the intermediary by such delivery warrants only his own good faith and authority even though he has purchased or made advances against the claim to be collected against the delivery. A broker is not an intermediary within the meaning of this subsection.

(4) A pledgee or other holder for security who redelivers the security received, or after payment and on order of the debtor delivers that security to a third person makes only the warranties of an intermediary under subsection (3).

(5) A broker gives to his customer and to the issuer and a purchaser the warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of his customer.

§8-307. Effect of Delivery Without Indorsement; Right to Compel Indorsement.

Where a security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied, but against the transferor the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

§8-308. Indorsement, How Made; Special Indorsement; Indorser Not a Guarantor; Partial Assignment.

(1) An indorsement of a security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or when the signature of such person is written without more upon the back of the security.

(2) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies the person to whom the security is to be transferred, or who has power to transfer it. A holder may convert a blank indorsement into a special indorsement.

(3) "An appropriate person" in subsection (1) means

(a) the person specified by the security or by special indorsement to be entitled to the security; or

(b) where the person so specified is described as a fiduciary but is no longer serving in the described capacity,—either that person or his successor; or

(c) where the security or indorsement so specifies more than one person as fiduciaries and one or more are no longer serving in the described capacity, the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; or

(d) where the person so specified is an individual and is without capacity to act by virtue of death, incompetence, infancy or otherwise, his executor, administrator, guardian or like fiduciary; or

(e) where the security or indorsement so specifies more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign, the survivor or survivors; or

(f) a person having power to sign under applicable law or controlling instrument; or

(g) to the extent that any of the foregoing persons may act through an agent, his authorized agent.

(4) Unless otherwise agreed the indorser by his indorsement assumes no obligation that the security will be honored by the issuer.

(5) An indorsement purporting to be only of part of a security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(6) Whether the person signing is appropriate is determined as of the date of signing and an indorsement by such a person does not be-

come unauthorized for the purposes of this Article by virtue of any subsequent change of circumstances.

(7) Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, does not render his indorsement unauthorized for the purposes of this Article.

§8-309. Effect of Indorsement Without Delivery.

An indorsement of a security whether special or in blank does not constitute a transfer until delivery of the security on which it appears or if the indorsement is on a separate document until the delivery of both the document and the security.

§8-310. Indorsement of Security in Bearer Form.

An indorsement of a security in bearer form may give notice of adverse claims (Section 8-304) but does not otherwise affect any right to registration the holder may possess.

§8-311. Effect of Unauthorized Indorsement.

Unless the owner has ratified an unauthorized indorsement or is otherwise precluded from asserting its ineffectiveness

(a) he may assert its ineffectiveness against the issuer or any purchaser other than a purchaser for value and without notice of adverse claims who has in good faith received a new, reissued or re-registered security on registration of transfer; and

(b) an issuer who registers the transfer of a security upon the unauthorized indorsement is subject to liability for improper registration (Section 8-404).

§8-312. Effect of Guaranteeing Signature or Indorsement.

(1) Any person guaranteeing a signature of an indorser of a security warrants that at the time of signing

(a) the signature was genuine; and

(b) the signer was an appropriate person to indorse (Section 8-308); and

(c) the signer had legal capacity to sign.

But the guarantor does not otherwise warrant the rightfulness of the particular transfer.

(2) Any person may guarante an indorsement of a security and by so doing warrants not only the signature (subsection 1) but also the

rightfulness of the particular transfer in all respects. But no issuer may require a guarantee of indorsement as a condition to registration of transfer.

(3) The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee and the guarantor is liable to such person for any loss resulting from breach of the warranties.

§8-313. When Delivery to the Purchaser Occurs; Purchaser's Broker as holder.

(1) Delivery to a purchaser occurs when

(a) he or a person designated by him acquires possession of a security; or

(b) his broker acquires possession of a security specially indorsed to or issued in the name of the purchaser; or

(c) his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser; or

(d) with respect to an identified security to be delivered while still in the possession of a third person when that person acknowledges that he holds for the purchaser; or

(e) appropriate entries on the books of a clearing corporation are made under Section 8-320.

(2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subparagraphs (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the broker or by the purchaser after the broker takes delivery as a holder for value is not effective either as to the broker or as to the purchaser. However, as between the broker and the purchaser the purchaser may demand delivery of an equivalent security as to which no notice of an adverse claim has been received.

§8-314. Duty to Deliver, When Completed.

(1) Unless otherwise agreed where a sale of a security is made on an exchange or otherwise through brokers

(a) the selling customer fulfills his duty to deliver when he places such a security in the possession of the selling broker or of a person designated by the broker or if requested causes an acknowledgment to be made to the selling broker that it is held for him; and

(b) the selling broker including a correspondent broker acting for a selling customer fulfills his duty to deliver by placing the security or a like security in the possession of the buying broker or a person designated by him or by effecting clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as otherwise provided in this section and unless otherwise agreed, a transferor's duty to deliver a security under a contract of purchase is not fulfilled until he places the security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by him or at the purchaser's request causes an acknowledgment to be made to the purchaser that it is held for him. Unless made on an exchange a sale to a broker purchasing for his own account is within this subsection and not within subsection (1).

§8-315. Action Against Purchaser Based Upon Wrongful Transfer.

(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security or obtain possession of any new security evidencing all or part of the same rights or have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement, the owner may also reclaim or obtain possession of the security or new security even from a bona fide purchaser if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements (Section 8-311).

(3) The right to obtain or reclaim possession of a security may be specially enforced and its transfer enjoined and the security impounded pending the litigation.

§8-316. Purchaser's Right to Requisites for Registration of Transfer on Books.

Unless otherwise agreed the transferor must on due demand supply his purchaser with any proof of his authority to transfer or with any other requisite which may be necessary to obtain registration of the transfer of the security but if the transfer is not for value a transferor need not do so unless the purchaser furnishes the necessary expenses. Failure to comply with a demand made within a reasonable time gives the purchaser the right to reject or rescind the transfer.

§8-317. Attachment or Levy Upon Security.

(1) No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy

but a security which has been surrendered to the issuer may be attached or levied upon at the source.

(2) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process.

§8-318. No Conversion by Good Faith Delivery.

An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling or otherwise dealing with securities) has received securities and sold, pledged or delivered them according to the instructions of his principal is not liable for conversion or for participation in breach of fiduciary duty although the principal had no right to dispose of them.

§8-319. Statute of Frauds.

A contract for the sale of securities is not enforceable by way of action or defense unless

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; or

(b) delivery of the security has been accepted or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment; or

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price.

§8-320. Transfer or Pledge within a Central Depository System.

(1) If a security

(a) is in the custody of a clearing corporation or of a custodian bank or a nominee of either subject to the instructions of the clearing corporation; and

(b) is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation or custodian bank or a nominee of either; and

(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.

(2) Under this section entries may be with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number or the like and, in appropriate cases, may be on a net basis taking into account other transfers or pledges of the same security.

(3) A transfer or pledge under this section has the effect of a delivery of a security in bearer form or duly indorsed in blank (Section 8-301) representing the amount of the obligation or the number of shares or rights transferred or pledged. If a pledge or the creation of a security interest is intended, the making of entries has the effect of a taking of delivery by the pledgee or a secured party (Sections 9-304 and 9-305). A transferee or pledgee under this section is a holder.

(4) A transfer or pledge under this section does not constitute a registration of transfer under Part 4 of this Article.

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries nor the liabilities or obligations of the clearing corporation to any person adversely affected thereby.

Part 4. Registration

§8-401. Duty of Issuer to Register Transfer.

(1) Where a security in registered form is presented to the issuer with a request to register transfer, the issuer is under a duty to register the transfer as requested if

(a) the security is indorsed by the appropriate person or persons (Section 8-308); and

(b) reasonable assurance is given that those indorsements are genuine and effective (Section 8-402); and

(c) the issuer has no duty to inquire into adverse claims or has discharged any such duty (Section 8-403).

(d) any applicable law relating to the collection of taxes has been complied with; and

(e) the transfer is in fact rightful or is to a bona fide purchaser.

(2) Where an issuer is under a duty to register a transfer of a security the issuer is also liable to the person presenting it for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer.

§8-402. Assurance that Indorsements Are Effective.

(1) The issuer may require the following assurance that each necessary indorsement (Section 8-308) is genuine and effective

(a) in all cases, a guarantee of the signature (subsection (1) of Section 8-312) of the person indorsing; and

(b) where the indorsement is by an agent, appropriate assurance of authority to sign;

(c) where the indorsement is by a fiduciary, appropriate evidence of appointment or incumbency;

(d) where there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(e) where the indorsement is by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility provided such standards are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means

(a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within sixty days before the date of presentation for transfer; or

(b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of such a document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to such

evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section but if it does so and for a purpose other than that specified in subsection 3(b) both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws or other controlling instrument it is charged with notice of all matters contained therein affecting the transfer.

§8-403. Limited Duty of Inquiry.

(1) An issuer to whom a security is presented for registration is under a duty to inquire into adverse claims if

(a) a written notification of an adverse claim is received at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security and the notification identifies the claimant, the registered owner and the issue of which the security is a part and provides an address for communications directed to the claimant; or

(b) the issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of Section 8-402.

(2) The issuer may discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered or certified mail at the address furnished by him or if there be no such address at his residence or regular place of business that the security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within thirty days from the date of mailing the notification, either

(a) an appropriate restraining order, injunction or other process issues from a court of competent jurisdiction; or

(b) an indemnity bond sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved, from any loss which it or they may suffer by complying with the adverse claim is filed with the issuer.

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of Section 8-402 or receives notification of an adverse claim under subsection (1) of this section, where a security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular

(a) an issuer registering a security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) an issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) the issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee.

§8-404. Liability and Non-Liability for Registration.

(1) Except as otherwise provided in any law relating to the collection of taxes, the issuer is not liable to the owner or any other person suffering loss as a result of the registration of a transfer of a security if

(a) there were on or with the security the necessary indorsements (Section 8-308); and

b) the issuer had no duty to inquire into adverse claims or has discharged any such duty (Section 8-403).

(2) Where an issuer has registered a transfer of a security to a person not entitled to it the issuer on demand must deliver a like security to the true owner unless

(a) the registration was pursuant to subsection (1); or

(b) the owner is precluded from asserting any claim for registering the transfer under subsection (1) of the following section; or

(c) such delivery would result in overissue, in which case the issuer's liability is governed by Section 8-104.

§8-405. Lost, Destroyed and Stolen Securities.

(1) Where a security has been lost, apparently destroyed or wrongfully taken and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving such a notification, the owner is precluded from asserting against the issuer any claim for registering

the transfer under the preceding section or any claim to a new security under this section.

(2) Where the owner of a security claims that the security has been lost, destroyed or wrongfully taken, the issuer must issue a new security in place of the original security if the owner

(a) so requests before the issuer has notice that the security has been acquired by a bona fide purchaser; and

(b) files with the issuer a sufficient indemnity bond; and

(c) satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of the new security, a bona fide purchaser of the original security presents it for registration of transfer, the issuer must register the transfer unless registration would result in overissue, in which event the issuer's liability is governed by Section 8-104. In addition to any rights on the indemnity bond, the issuer may recover the new security from the person to whom it was issued or any person taking under him except a bona fide purchaser.

§8-406. Duty of Authenticating Trustee, Transfer Agent or Registrar.

(1) Where a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its securities or in the issue of new securities or in the cancellation of surrendered securities

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) he has with regard to the particular functions he performs the same obligation to the holder or owner of the security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by the agent.

Appendix D

Extract from the United States Trust Indenture Act of 1939

Necessity for Regulation

SEC. 302. (a) Upon the basis of facts disclosed by the reports of the Securities and Exchange Commission made to the Congress pursuant to section 211 of the Securities Exchange Act of 1934 and otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors in notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, which are offered to the public, are adversely affected—

(1) when the obligor fails to provide a trustee to protect and enforce the rights and to represent the interests of such investors, notwithstanding the fact that (A) individual action by such investors for the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action, and (B) concerted action by such investors in their common interest through representatives of their own selection is impeded by reason of the wide dispersion of such investors through many States, and by reason of the fact that information as to the names and addresses of such investors generally is not available to such investors;

(2) when the trustee does not have adequate rights and powers, or adequate duties and responsibilities, in connection with matters relating to the protection and enforcement of the rights of such investors; when, notwithstanding the obstacles to concerted action by such investors, and the general and reasonable assumption by such investors that the trustee is under an affirmative duty to take action for the protection and enforcement of their rights, trust indentures (A) generally provide that the trustee shall be under no duty to take any such action, even in the event of default, unless it receives notice of default, demand for action, and indemnity, from the holders of substantial percentages of the securities outstanding thereunder, and (B) generally relieve the trustee from liability even for its own negligent action or failure to act;

(3) when the trustee does not have resources commensurate with its responsibilities, or has any relationship to or connection with the obligor or any underwriter of any securities of the obligor, or holds, beneficially or otherwise, any interest in the obligor or any such underwriter, which relationship, connection, or interest involves a material conflict with the interests of such investors;

(4) when the obligor is not obligated to furnish to the trustee under the indenture and to such investors adequate current information as to its financial condition, and as to the performance of its obligations with

respect to the securities outstanding under such indenture; or when the communication of such information to such investors is impeded by the fact that information as to the names and addresses of such investors generally is not available to the trustee and to such investors:

(5) when the indenture contains provisions which are misleading or deceptive, or when full and fair disclosure is not made to prospective investors of the effect of important indenture provisions; or

(6) when, by reason of the fact that trust indentures are commonly prepared by the obligor or underwriter in advance of the public offering of the securities to be issued thereunder, such investors are unable to participate in the preparation thereof, and, by reason of their lack of understanding of the situation, such investors would in any event be unable to procure the correction of the defects enumerated in this subsection.

(b) Practices of the character above enumerated have existed to such an extent that, unless regulated, the public offering of notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, by the use of means and instruments of transportation and communication in interstate commerce and of the mails, is injurious to the capital markets, to investors, and to the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the practices, enumerated in this section, connected with such public offerings.

Disqualification of Trustee

Sec. 310 (b) The indenture to be qualified shall provide that if any indenture trustee has or shall acquire any conflicting interest as hereinafter defined, (i) such trustee shall, within ninety days after ascertaining that it has such conflicting interest, either eliminate such conflicting interest or resign, such resignation to become effective upon the appointment of a successor trustee and such successor's acceptance of such appointment, and the obligor upon the indenture securities shall take prompt steps to have a successor appointed in the manner provided in the indenture; and (ii) in the event that such trustee shall fail to comply with the provisions of clause (i) of this subsection, such trustee shall, within ten days after the expiration of such ninety-day period, transmit notice of such failure to the indenture security holders in the manner and to the extent provided in subsection (c) of section 313; and (iii) subject to the provisions of subsection (e) of section 315, any security holder who has been a bona fide holder of indenture securities for at least six months may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction for the removal of such trustee, and the appointment of a successor, if such trustee fails,

after written request therefor by such holder, to comply with the provisions of clause (i) of this subsection. For the purposes of this subsection, an indenture trustee shall be deemed to have a conflicting interest if—

(1) such trustee is trustee under another indenture under which any other securities, or certificates of interest or participation in any other securities, of an obligor upon the indenture securities are outstanding unless (A) the indenture securities are collateral trust notes under which the only collateral consists of securities issued under such other indenture, or (B) such other indenture is a collateral trust indenture under which the only collateral consists of indenture securities, or (C) such obligor has no substantial unmortgaged assets and is engaged primarily in the business of owning, or of owning and developing and/or operating, real estate, and the indenture to be qualified and such other indenture are secured by wholly separate and distinct parcels of real estate: *Provided,* That the indenture to be qualified may contain a provision excluding from the operation of this paragraph another indenture or indentures under which other securities, or certificates of interest or participation in other securities, of such an obligor are outstanding, if (i) the indenture to be qualified and such other indenture or indentures are wholly unsecured, and such other indenture or indentures are specifically described in the indenture to be qualified or are thereafter qualified under this title, unless the Commission shall have found and declared by order pursuant to subsection (b) of section 305 or subsection (c) of section 307 that differences exist between the provisions of the indenture to be qualified and the provisions of such other indenture or indentures which are so likely to involve a material conflict of interest as to make it necessary in the public interest or for the protection of investors to disqualify such trustee from acting as such under one of such indentures, or (ii) the issuer shall have sustained the burden of proving, on application to the Commission and after opportunity for hearing thereon, that trusteeship under the indenture to be qualified and such other indenture is not so likely to involve a material conflict of interest as to make it necessary in the public interest or for the protection of investors to disqualify such trustee from acting as such under one of such indentures;

(2) such trustee or any of its directors or executive officers is an obligor upon the indenture securities or an underwriter for such an obligor;

(3) such trustee directly or indirectly controls or is directly or indirectly controlled by or is under direct or indirect common control with an obligor upon the indenture securities or an underwriter for such an obligor;

(4) such trustee or any of directors or executive officers is a director, officer, partner, employee, appointee, or representative of an obligor upon the indenture securities, or of an underwriter (other than the trustee itself) for such an obligor who is currently engaged in the business of underwriting, except that (A) one individual may be a director and/or an executive officer of the trustee and a director and/or an executive officer of such obligor, but may not be at the same time an executive officer of both the trustee and of such obligor, and (B) if and so long as the number of directors of the trustee in office is more than nine, one additional individual may be a director and/or an executive officer of the trustee and a director of such obligor, and (C) such trustee may be designated by any such obligor or by any underwriter for any such obligor, to act in the capacity of transfer agent, registrar, custodian, paying agent, fiscal agent, escrow agent, or depositary, or in any other similar capacity, or, subject to the provisions of paragraph (1) of this subsection, to act as trustee, whether under an indenture or otherwise;

(5) 10 per centum or more of the voting securities of such trustee is beneficially owned either by an obligor upon the indenture securities or by any director, partner, or executive officer thereof, or 20 per centum or more of such voting securities is beneficially owned, collectively, by any two or more of such persons; or 10 per centum or more of the voting securities of such trustee is beneficially owned either by an underwriter for any such obligor or by any director, partner, or executive officer thereof, or is beneficially owned, collectively, by any two or more such persons;

(6) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, (A) 5 per centum or more of the voting securities, or 10 per centum or more of any other class of security, of an obligor upon the indenture securities, not including indenture securities and securities issued under any other indenture under which such trustee is also trustee, or (B) 10 per centum or more of any class of security of an underwriter for any such obligor;

(7) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, 5 per centum or more of the voting securities of any person who, to the knowledge of the trustee, owns 10 per centum or more of the voting securities of, or controls directly or indirectly or is under direct or indirect common control with, an obligor upon the indenture securities;

(8) such trustee is the beneficial owner of, or holds as collateral security for an obligation which is in default as hereinafter defined, 10 per centum or more of any class of security of any person who, to

the knowledge of the trustee, owns 50 per centum or more of the voting securities of an obligor upon the indenture securities; or

(9) such trustee owns, on May 15 in any calendar year, in the capacity of executor, administrator, testamentary or inter vivos trustee, guardian, committee or conservator, or in any other similar capacity, an aggregate of 25 per centum or more of the voting securities, or of any class of security, of any person, the beneficial ownership of a specified percentage of which would have constituted a conflicting interest under paragraph (6), (7), or (8) of this subsection. The indenture to be qualified may provide, as to any such securities of which the indenture trustee acquired ownership through becoming executor, administrator, or testamentary trustee of an estate which included them, that the provision of the preceding sentence shall not apply, for a period of not more than two years from the date of such acquisition, to the extent that such securities included in such estate do not exceed 25 per centum of such voting securities or 25 per centum of any such class of security. The indenture to be qualified shall provide that promptly after May 15 in each calendar year, the trustee shall make a check of its holdings of such securities in any of the above-mentioned capacities as of such May 15. Such indenture shall also provide that if the obligor upon the indenture securities fails to make payment in full of principal or interest under such indenture when and as the same becomes due and payable, and such failure continues for thirty days thereafter, the trustee shall make a prompt check of its holdings of such securities in any of the above-mentioned capacities as of the date of the expiration of such thirty-day period, and after such date, notwithstanding the foregoing provisions of this paragraph, all such securities so held by the trustee, with sole or joint control over such securities vested in it, shall be considered as though beneficially owned by such trustee, for the purposes of paragraphs (6), (7), and (8) of this subsection.

The indenture to be qualified shall provide that the specification of percentages in paragraphs (5) to (9), inclusive, of this subsection shall not be construed as indicating that the ownership of such percentages of the securities of a person is or is not necessary or sufficient to constitute direct or indirect control for the purposes of paragraphs (3) or (7) of this subsection.

For the purposes of paragraphs (6), (7), (8), and (9) of this subsection, (A) the terms "security" and "securities" shall include only such securities as are generally known as corporate securities, but shall not include any note or other evidence of indebtedness issued to evidence an obligation to repay moneys lent to a person by one or more banks, trust companies, or banking firms, or any certificate of interest or participation in any such note or evidence of indebtedness; (B) an

obligation shall be deemed to be in default when a default in payment of principal shall have continued for thirty days or more, and shall not have been cured; and (C) the indenture trustee shall not be deemed the owner or holder of (i) any security which it holds as collateral security (as trustee or otherwise) for an obligation which is not in default as above defined, or (ii) any security which it holds as collateral security under the indenture to be qualified, irrespective of any default thereunder, or (iii) any security which it holds as agent for collection, or as custodian, escrow agent, or depositary, or in any similar representative capacity.

For the purposes of this subsection, the term "underwriter" when used with reference to an obligor upon the indenture securities means every person who, within three years prior to the time as of which the determination is made, was an underwriter of any security of such obligor outstanding at such time.

Evidence of Recording of Indenture

SEC. 314. (b) If the indenture to be qualified is or is to be secured by the mortgage or pledge of property, such indenture shall contain provisions requiring the obligor upon the indenture securities to furnish to the indenture trustee—

(1) promptly after the execution and delivery of the indenture, an opinion of counsel (who may be of counsel for such obligor) either stating that in the opinion of such counsel the indenture has been properly recorded and filed so as to make effective the lien intended to be created thereby, and reciting the details of such action, or stating that in the opinion of such counsel no such action is necessary to make such lien effective; and

(2) at least annually after the execution and delivery of the indenture, an opinion of counsel (who may be of counsel for such obligor) either stating that in the opinion of such counsel such action has been taken with respect to the recording, filing, re-recording, and refiling of the indenture as is necessary to maintain the lien of such indenture, and reciting the details of such action, or stating that in the opinion of such counsel no such action is necessary to maintain such lien.

Evidence of Compliance With Conditions Precedent

Sec. 314 (c) The indenture to be qualified shall contain provisions requiring the obligor upon the indenture securities to furnish to the indenture trustee evidence of compliance with the conditions precedent, if any, provided for in the indenture (including any covenants compliance with which constitutes a condition precedent) which relate to the authen-

tication and delivery of the indenture securities, to the release or the release and substitution of property subject to the lien of the indenture, to the satisfaction and discharge of the indenture, or to any other action to be taken by the indenture trustee at the request or upon the application of such obligor. Such evidence shall consist of the following:

(1) certificates or opinions made by officers of such obligor who are specified in the indenture, stating that such conditions precedent have been complied with;

(2) an opinion of counsel (who may be of counsel for such obligor) stating that in his opinion such conditions precedent have been complied with; and

(3) in the case of conditions precedent compliance with which is subject to verification by accountants (such as conditions with respect to the preservation of specified ratios, the amount of net quick assets, negative-pledge clauses, and other similar specific conditions), a certificate or opinion of an accountant, who, in the case of any such conditions precedent to the authentication and delivery of indenture securities, and not otherwise, shall be an independent public accountant selected or approved by the indenture trustee in the exercise of reasonable care, if the aggregate principal amount of such indenture securities and of other indenture securities authenticated and delivered since the commencement of the then current calendar year (other than those with respect to which a certificate or opinion of an accountant is not required, or with respect to which a certificate or opinion of an independent public accountant has previously been furnished) is 10 per centum or more of the aggregate amount of the indenture securities at the time outstanding; but no certificate or opinion need be made by any person other than an officer or employee of such obligor who is specified in the indenture, as to (A) dates or periods not covered by annual reports required to be filed by the obligor, in the case of conditions precedent which depend upon a state of facts as of a date or dates or for a period or periods different from that required to be covered by such annual reports, or (B) the amount and value of property additions, except as provided in paragraph (3) of subsection (d), or (C) the adequacy of depreciation, maintenance, or repairs.

Recitals as to Basis of Certificate or Opinion

(e) Each certificate or opinion with respect to compliance with a condition or covenant provided for in the indenture shall include (1) a statement that the person making such certificate or opinion has read such covenant or condition; (2) a brief statement as to the nature and scope of the examination or investigation upon which the statements or

opinions contained in such certificate or opinion are based; (3) a statement that, in the opinion of such person, he has made such examination or investigation as is necessary to enable him to express an informed opinion as to whether or not such covenant or condition has been complied with; and (4) a statement as to whether or not, in the opinion of such person, such condition or covenant has been complied with.

Parties May Provide for Additional Evidence

(f) Nothing in this section shall be construed either as requiring the inclusion in the indenture to be qualified of provisions that the obligor upon the indenture securities shall furnish to the indenture trustee any other evidence of compliance with the conditions and covenants provided for in the indenture than the evidence specified in this section, or as preventing the inclusion of such provisions in such indenture, if the parties so agree.

Duties and Responsibility of the Trustee

Duties Prior to Default

Sec. 315. (a) The indenture to be qualified may provide that, prior to default (as such term is defined in such indenture)—

(1) the indenture trustee shall not be liable except for the performance of such duties as are specifically set out in such indenture; and

(2) the indenture trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, in the absence of bad faith on the part of such trustee, upon certificates or opinions conforming to the requirements of the indenture;

but such indenture shall contain provisions requiring the indenture trustee to examine the evidence furnished to it pursuant to section 314 to determine whether or not such evidence conforms to the requirements of the indenture.

Notice of Defaults

(b) The indenture to be qualified shall contain provisions requiring the indenture trustee to give to the indenture security holders, in the manner and to the extent provided in subsection (c) of section 313, notice of all defaults known to the trustee, within ninety days after the occurrence thereof: *Provided,* That such indenture may provide that, except in the case of default in the payment of the principal or of interest on any indenture security, or in the payment of any sinking or purchase fund installment, the trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee, or a trust committee of directors and/or responsible officers, of

the trustee in good faith determine that the withholding of such notice is in the interests of the indenture security holders.

Duties of the Trustee in Case of Default

(c) The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstance in the conduct of his own affairs.

Responsibility of the Trustee

(d) The indenture to be qualified shall not contain any provisions relieving the indenture trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that—

(1) such indenture may contain the provisions authorized by paragraphs (1) and (2) of subsection (a) of this section;

(2) such indenture may contain provisions protecting the indenture trustee from liability for any error of judgment made in good faith by a responsible officer or officers of such trustee, unless it shall be proved that such trustee was negligent in ascertaining the pertinent facts; and

(3) such indenture may contain provisions protecting the indenture trustee with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the holders of not less than a majority in principal amount of the indenture securities at the time outstanding (determined as provided in subsection (a) of section 316) relating to the time, method, and place of conducting any proceeding for any remedy available to such trustee, or exercising any trust or power conferred upon such trustee, under such indenture.

Appendix E

Form letter mailed to corporations

Gordon R. Carton, Q.C., M.P.P.
R. Alan Eagleson, M.P.P.
Lorne C. Henderson, M.P.P.
Leonard M. Reilly, M.P.P.
James Renwick, M.P.P.
Vernon M. Singer, Q.C., M.P.P.
Elmer W. Sopha, Q.C., M.P.P.
Ivan W. Thrasher, M.P.P.
Robert Welch, M.P.P.

ONTARIO
LEGISLATIVE ASSEMBLY
SELECT COMMITTEE ON COMPANY LAW
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Lionel H. Schipper
SECRETARY
C. D. S. Robertson
DIRECTOR OF RESEARCH
S. Lavine

Presentations and Briefs are invited from interested persons or organizations to the Select Committee on Company Law recently empowered by the Ontario Legislature to inquire into and study the field of Corporate Law.

The Committee would welcome your participation. It is anticipated that the Committee will hold Public Hearings in Toronto and elsewhere as required during the forthcoming Autumn and Winter.

The Committee's deliberations would be facilitated if all persons who desire to make representations, oral or written, during the above-noted first phase of the Committee's activities would advise the Secretary of the Committee, Mr. C. D. S. Robertson, at the Offices of the Committee, Provincial Secretary's Department, Parliament Buildings, Queen's Park, Box 234, Toronto, before the 15th day of September, 1965.

(Signed) Allan F. Lawrence

Allan F. Lawrence, Q.C., M.P.P.,
Chairman.

APPENDIX F

Questionnaire constituting list of research topics

RESEARCH TOPICS

I. FORMATION OF CORPORATIONS AND MATTERS INCIDENTAL THERETO

1. Should incorporation be a matter of right or of ministerial discretion?
2. What should the requirements be with respect to minimum membership, minimum number of directors, minimum paid up capital? i.e. Should one-man companies be permitted?
3. Should companies be prohibited from carrying on business in names other than their own?
4. Should there be a central registry in Ontario for all corporate and business names?
5. Objects—Should companies be permitted to enter into new unrelated activities without the prior approval of their shareholders?
6. Should the doctrine of "ultra vires" be abolished by legislation?
7. Should all corporations, including credit unions and loan and trust corporations be brought under The Corporations Act?

II. CLASSIFICATION OF CORPORATIONS

8. Should the distinction between public and private companies be abolished?
9. Should companies be required to file copies of their financial statements? If so, should these statements be made available to all members of the public?

III. DIRECTORS AND OFFICERS — THEIR DUTIES, QUALIFICATIONS AND METHOD OF APPOINTMENT

10. What are the duties of a director to the company, to its shareholders, to others?
11. Should directors be required to be shareholders of the companies of which they are directors?
12. Should cumulative voting for the election of directors and the right to remove directors before the expiration of their term of office be made mandatory instead of optional as at present?
13. Should officers of companies be subject to appointment and removal by the shareholders directly?

IV. MEETINGS OF DIRECTORS AND SHAREHOLDERS, MANAGEMENT AND ADMINISTRATION GENERALLY

14. Should the directors and shareholders have the right to dispense with the necessity for holding meetings?
15. Should shareholders have the power to initiate by-laws?
16. Should companies be permitted to use electronic data processing equipment for maintaining their corporate records?
17. Should the procedure for transferring shares be simplified?
18. Should the right of shareholders to appoint proxies be subject to restriction?
19. Should the filing of annual returns with the Provincial Secretary be abolished and, if not, is all the information now required really necessary?

V. PROVISIONS FOR THE PROTECTION OF SHAREHOLDERS AND CREDITORS

20. To what extent should directors and officers be accountable to the shareholders and creditors of the company?
21. Should a majority of the shareholders have the right to buy out the minority on a takeover bid? After a successful take over bid should a minority of shareholders have the right to require the majority to buy them out?
22. Should amalgamations and capital reorganizations require court approval where there are dissenting shareholders?
23. To what extent should companies be required to disclose financial information to their shareholders? to creditors and to members of the public dealing with the companies?
24. Should stock options to directors and officers require prior shareholder approval?
25. Under what circumstances should dissenting shareholders have the right to sell their shares to the company.
26. An analysis of the relationship between the shareholders of public companies and management of such companies.
27. Are creditors of corporations that are proposing to dissolve adequately protected?
28. A critical analysis of Foss v. Harbottle.

VI. ACCOUNTS AND AUDITORS

29. What are "proper" books of accounts or financial statements of corporations?

30. Should the Corporations Act prescribe the qualifications of auditors?

31. What should the responsibility of auditors be with respect to the financial statements of companies? Should these responsibilities be prescribed by the Corporations Act?

32. Under what circumstances should the auditors be required or entitled to attend meetings of shareholders?

VII. SHARE CAPITAL

33. Should companies be permitted to purchase their own common shares?

34. Should non-voting common or equity shares be permitted?

VIII. ENFORCEMENT OF PROVISIONS OF THE CORPORATIONS ACT AND INVESTIGATION OF THE AFFAIRS OF CORPORATIONS

35. Should Section 2.10 of the Companies Act of Great Britain (which gives the court jurisdiction to interfere where the affairs of a company are being conducted in a manner oppressive to a minority of the shareholders) be adopted in Ontario?

36. Should the Provincial Secretary or some other minister of the Crown have the power and duty to investigate the affairs of corporations where, for example, fraud or mismanagement is alleged or suspected and should he have the right and responsibility to apply to the court on behalf of aggrieved shareholders to require corporations to carry out the duties imposed upon them by the Corporations Act?

37. An analysis of the enforcement of the provisions of the Corporations Act and related statutes.

IX. CO-OPERATIVES

38. What is a co-operative?

39. If the concept of the co-operative is to be continued to what extent should the operation of a co-operative be subject to regulation under the Corporations Act?

X. RELATED STATUTES

40. The Mortmain and Charitable Uses Act — Should the restrictions on corporations acquiring land now contained in this Act be abolished.

41. The Corporations Information Act.

42. The Corporations Securities Registration Act.

43. The Partnerships Act.

44. The Limited Partnerships Act.

45. The Partnership Registration Act.

46. The Securities Act.

XI. MISCELLANEOUS

47. Should non-profit corporations be prohibited from distributing their surplus property to their members on dissolution?

48. Foreign corporations.

49. Pre-incorporation contracts.

50. A critical comparative analysis of the rights of dissenting shareholders—U.K., U.S. and Canadian Law.

51. A critical appraisal of the role of the auditor.

Appendix G

Partial list of persons and organizations who submitted written briefs, communications or suggestions.

Appleton Air Conditioning Limited—Toronto

Professor C. A. Ashley

Association of Medical Clinics

Association of Professional Engineers of the Province of Ontario

Baptist Federation of Canada—Rev. E. Bailey

Beacon Chemicals Limited—Milton, Ontario

Wallace Beaton, B.Com. C.A.—Woodbridge, Ontario

Board of Directors of Physiotherapy of Ontario

Board of Opthalmic Dispensers

Board of Trade for Metropolitan Toronto

Burlington Professional Association

Canadian Bar Association—Ontario Section

Canadian Credit Men's Association Ltd.

Canadian Life Insurance Association

Canadian Lumbermen's Association

Canadian Manufacturers' Association

Canadian Plumbing and Mechanical Contractors Ltd.

Canadian Red Cross Society

Cedar Street Properties, Ltd.—Sudbury, Ontario

Chartered Institute of Secretaries

Clarkson Company Limited

College of Optometrists of Ontario

College of Physicians & Surgeons

Commercial Studios—Toronto

Consulting Engineers of Canada

Co-Operative Unions of Ontario

Corporation Trust Company—New York

Department of the Attorney General

Department of Economics & Development

Department of the Provincial Secretary

Durall Limited—Winnipeg

Eastwood Construction Company Limited—Peterborough

Enmar Machine Works Limited—Toronto

Equitable Income Tax Foundation—Montreal

Family Security Agencies Limited—Toronto

General Motors Corporation

Governing Board of Dental Technicians

Warren S. Green, B.A., LL.B.—Toronto

T. H. Hancock—Toronto

F. Hayward, F.A.E.—Claremont, Ontario

W. H. S. Henderson—Calgary, Alta.

Hill Business Machines—Ottawa

Holden, Murdock, Walton, Finlay, Robinson & Pepall—Toronto

Holmested, Sutton, Hill & Kemp—Toronto

Institute of Chartered Accountants

Investment Dealers Association of Canada

Basil V. Jesshope—Toronto

J. Klassen & Associates Limited—Ottawa

R. Laidlaw Lumber Company Limited

Legislative Counsel

Lincoln Plumbing & Heating Limited—St. Catharines

MacDonald & Kennedy—Toronto

Manning, Bruce, Paterson & Ridout—Toronto

Marshall & Russell—Orillia

E. D. K. Martin—Toronto
Merredith & Finlayson—Ottawa
Metropolitan Equities Limited—Toronto
Morrison-Lamothe Bakery Limited—Ottawa

Arthur J. Nash—Dundas, Ontario
Noranda Mines Limited

Ontario Chamber of Commerce
Ontario Federation of Construction Association
Ontario Medical Association
Ontario Veterinary Society

Palmer Thermometer Company Limited—Toronto
E. H. Pooler—Toronto
Property Owners Association of Toronto and Ontario

Rigmil Limited—Kitchener, Ontario
A. M. Ross—Philadelphia, Pa.
Royal College of Dental Surgeons of Ontario

John B. Sampson—Kingston, Ontario
Dr. Morton P. Shulman—Toronto
B. B. Skekter, Q.C.—Hamilton, Ontario
Smiles 'n Chuckles Limited—Kitchener
J. C. Smith, Q.C.—Fort Frances
Professor J. E. Smyth—University of Toronto
Society of Industrial and Cost Accountants

Tenace Tools Limited—Cooksville
Newton A. Thomas, B.A.—New Hamburg
J. I. Thomson Limited—Owen Sound
Trans-Western Oils Limited—Calgary
Trust Companies Association

United Automobile-Aerospace-Agricultural Implement Workers of America

Vass, Mitchell & Kerenyi—Toronto

Volkswagen Canada Limited—Toronto

Irvine H. Williams—Toronto

Ward & Eckel—Woodstock

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Not for Publication
or Public Comment
Before 2:30 p.m.
Tuesday, April 4th,
1967.

SUMMARY OF THE HIGHLIGHTS AND RECOMMENDATIONS OF THE LAWRENCE COMMITTEE REPORT ON COMPANY LAW.

1. Public policy should be to encourage the formation and use of the Corporate form.

2. Artificialities in the law and legal fictions, should be avoided.

* 3. The existing discretion of the Provincial Secretary to grant incorporation of general corporations should be removed.

* 4. The present method of incorporation should be changed to a system of filing a Certificate of Incorporation.

* 5. Companies having only one shareholder should be permitted.

* 6. Closely held companies having only one director is recommended.

7. There should be no requirement respecting minimum paid up capital.

8. Companies should be legally liable for most pre-incorporation contracts.

* 9. The existing distinctions between public and private companies should be abolished.

* 10. Professional groups such as lawyers, doctors, accountants and others should be permitted to incorporate in special "Professional Service Corporations".

* 11. A Central Registry for all corporate and business names used in the province is advocated.

12. The rule of "Constructive Notice" respecting corporations should be abolished.

13. The dangers of the "Ultra Vires Doctrine" should be removed from Ontario Law.

14. The suggestion that there should be non-voting common shares is rejected.

15. Companies should be able to purchase their own common shares under certain conditions.

16. Technical difficulties discouraging the incorporation in Ontario of Mutual Fund Companies should be removed.

* 17. Ontario law respecting the Transfer of Share Certificates should be completely up-dated by enacting a modern "Securities Transfer Code": The actual legislation is set out in Appendix "C" and emphasizes the modern concept of negotiability of share certificates.

* 18. A whole new transfer system is advocated, modelled after the central depository system operated by the Stock Clearing Corporation of the New York Stock Exchange: this will result in a complete up-dating of stock transfer practices.

* DIRECTORS

19. Directors duties, for the first time, are affirmatively defined and a stricter statutory standard of conduct and care of directors is indicated as being an urgent problem.

20. Legal procedural doctrines now preventing shareholders from suing directors should be swept away and new rules, following the American pattern, to permit shareholders to sue directors are advocated, e.g. the so-called "derivative suit" should be permitted under strict Court control.

21. The rights of minority shareholders should be strengthened.

22. "Conflict of Interest" restrictions on directors must be tightened and existing loop-holes in the law plugged: Directors should be required to declare and disclose any transaction directly or indirectly involving themselves and the company.

23. Directors should no longer be permitted to be indemnified by the company respecting the costs of legal actions against themselves.

* SHAREHOLDERS

24. New rules are advocated to enlarge and to enforce the rights of individual shareholders.

25. The arguments for mandatory cumulative voting requirements are rejected.

26. New rights should be given to shareholders so that they may remove directors.

27. New rights should be given to shareholders so that they may requisition meetings of the company.

28. New rights should be given shareholders so that they may initiate investigations of the affairs of companies.

29. Present legal fictions respecting formal directors' meetings should be removed.

30. Existing artificialities in the law respecting shareholders' meetings should be removed.

* AUDITORS

31. The absolute independence of Auditors should be assured.

32. Statutory prohibitions respecting Auditors should be enlarged so that there can be no conflict of interest.

33. New safeguards are advocated so that the Auditor should be at all times acting in the interests of the shareholders.

34. Amendments to provide that an auditor shall not be appointed Receiver or Liquidator or Trustee in Bankruptcy are advocated.

35. An Audit Committee of the Directors should be mandatory and Auditors should be required to appear annually before such a Committee.

36. Restrictions on the removal of the Auditor by Management are recommended.

37. New provisions to permit the Auditor to attend meetings and to be heard are suggested.

38. Shareholders should be able to require the attendance of Auditors at Shareholders' Meetings.

39. The Auditor should be required to answer proper enquiries directed to him at Shareholders' Meetings.

40. Auditors of Holding Companies should be made legally responsible for the audit of subsidiary companies.

* TRUSTEES

41. The enactment of a "Trust Indenture Act" is asked for, and draft legislation is suggested.

42. The standard of care of Trustees under Trust Indentures should be greatly enlarged.

43. New "conflict of interest" provisions respecting Trustees under Trust Indentures are advocated.

44. The responsibilities of Trustees under Trust Indentures are incompatible with the duties of Receivers, and the current practices are severely criticized. Trustees should not be Receivers.

MISCELLANEOUS

45. Antiquated laws respecting land owned by charitable institutions should be repealed.

46. Ontario's Mortmain legislation should be repealed.

47. Companies not selling their shares to the public should not have to disclose their financial statements to the general public.

* 48. A specialized "Companies Court" as a division of the Supreme Court of Ontario is advocated.

49. Many less important procedural suggestions are made in the hope that the Ontario law can be more easily observed and understood, and more efficiently administered.

50. The Committee should be reconstituted so that it may amplify the recommendations in this Interim Report and so that it can investigate existing problem areas in respect of (among others):

(a) Ontario's Securities Legislation and Corporate Financing.

(b) Credit Unions

(c) Co-Operatives

(d) Insurance Companies

(e) Finance and Acceptance Companies

(f) Loan and Trust Companies

(g) Corporations without Share Capital, i.e. Charities and Social Clubs.

(h) Extra-Provincial Corporations.

(i) Mergers and Amalgamations

(j) Annual Returns

(k) The fundamental changes of an existing corporation's activities.

(l) Protection for a corporation's creditors.

(m) The administration of new Department of Commercial Affairs as compared to the Provincial Secretary's Department.

51. This Report, although interim only, is the result of two years' study and research "of a depth never before attempted by a Legislative Committee".

NB - recommendations marked *.

AFL:n
April, 1967.

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